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Implementation of IAS in SKF

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Abstract

This is a case study of the implementation of International Accounting Standards (IAS) in SKF. In 2002 the EU approved the adoption of a regulation that all companies within the EU, listed on a regulated market, had to prepare consolidated accounts in accordance with IAS by 2005 at the latest. SKF has been listed on both the Swedish and US stock exchanges. The company therefore has to follow both Swedish and US generally accepted accounting principles (GAAP). Hence, SKF's GAAP is a mixture between US GAAP and Swedish GAAP.

The purpose of this thesis is to compare IAS and SKF GAAP. Thus, these assessed differences and implementation effects for SKF are the basis of our analysis.

SKF has realised that the implementation of IAS are more time consuming than first expected. The implementation of IAS 19 – Employee Benefits, IAS 29 – Financial Reporting In Hyperinflationary Economies, and IAS 39 – Financial Instruments: Recognition And Measurement can be difficult due to major changes in SKF GAAP and the lack of available information at present that is required for these standards.

SKF should devote resources for IAS 29. Through the use of project groups and discussions with the employees in the organisation who are affected by the new accounting standard, the instructions and understanding within the subsidiaries would be improved. Finally, SKF could save both time and money by demanding that the company's subsidiaries use IAS in the subsidiaries' local accounts, given that use of IAS is allowed due to local legislation.

Keywords: International Accounting Standards (IAS), implementation process, Generally Accepted Accounting Principles (GAAP), multinational company

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1 Introduction

This chapter starts with a general background to international accounting standards. After that the main reason for this thesis, the assignment from SKF, is discussed. Then there will be a description of the research issue, which will end up describing the purpose of the thesis. Finally the scope and limitations of the thesis are assessed.

1.1 Background

The more and more integrated economy has given multinational companies (MNC) the opportunity to increase its sales into new markets and also the chance to raise capital, both debt and equity, in foreign countries. In order to raise capital in foreign countries the MNCs have to be listed on several financial markets. Thus, the MNCs' shares get higher liquidity, which leads to cheaper finance. This globalisation process also affects investors who can invest in companies from other countries than the investors' home countries. The lack of accounting harmonization is a problem since investors and companies do not easily understand the diversity of accounting principles and standards. Also, the cost for the MNC when preparing multiple sets of accounts and reports is high. There is therefore a call for international accounting harmonization (Combarros, 2000; Gray et al, 2001).

A number of organisations have been concerned with harmonizing international differences in accounting and reporting, including the United Nations, the World Bank, and the European Union (EU) etc. But, the most important body is the International Accounting Standards Board (IASB). The IASB was established in 1973 by leading professional accounting organizations (Most, 1994; Gray et al, 2001). The IASB is “*committed to developing, in the public interest, a single set of high quality, global accounting standards that require transparent and comparable information in general purpose financial statements.*” (IASB, 2002a, p. 1). Further, the IASB cooperates with national accounting standard setters to achieve convergence in accounting standards around the world. In 2000 the International Organization of Securities Commission (IOSCO) recommended its members, the main regulators of stock exchanges, to allow MNCs to use International Accounting Standards (IAS) (IOSCO, Website). Still, IOSCO members, and especially the United States, have not yet accepted IAS wholeheartedly as global standards with equal, if not greater, status compared to domestic standards (Gray et al, 2001).

However, a step toward harmonization was reached on October 29, 2002, when the FASB and the IASB published a press release concerning a memorandum of understanding, marking a significant step toward formalizing their commitment to the convergence of US and international accounting standards. The FASB and the IASB presented the agreement to a commitment to adopt compatible, high-quality solutions to existing and future accounting issues (IASB, Website).

On June 13th 2000, the European Commission (EC) adopted its communication 'The EU's Financial Reporting Strategy: The Way Forward' (European Commission, 2000). This would require all companies within the EU listed on a regulated market to prepare consolidated accounts in accordance with IAS. The regulation, which would enter into force at the latest in 2005, would help eliminate barriers to cross border trading in securities by ensuring that companies' accounts throughout the EU are more transparent and can be more easily compared (European Commission, 2001). In February 2001 the EC presented a proposal on the issue, and on March 12th 2002 the Parliament endorsed the proposal after a vote. Finally, on July 19th 2002, the Council of Ministers of the EU approved the adoption of the regulation proposed by the European Commission (European Parliament, 2002). Before this regulation the EU has undertaken initiatives designed to harmonize the legal systems of the member states. These have taken the form of the Fourth and Seventh Directive. However, these directives admit a quantity of possibilities and options, thus in practice there is no harmonized regulation in the EU regarding accounting matters. Since one of the objectives of the EU is a single market with free movement for people and capital, the establishment of an integrated financial services and securities market operating with a single currency, there is a need for harmonization of accounting standards (Combarros, 2000).

However, the rest of the world is still divided on the issue, which threatens the world's progress toward a single acceptable language of accounting. Presently, US domestic companies must meet the US generally accepted accounting principles (GAAP) set by the Financial Accounting Standards Board (FASB) and the Securities and Exchange Commission (SEC) (Cheney, 2002). SEC currently requires foreign companies to disclose the differences between US GAAP and IAS, if financial statements are filed under the IASB's standards (SEC, Website).

1.2 The Assignment

The origin of this thesis is that we have been given an assignment by SKF with the purpose of finding out what SKF needs to change in order to fulfil the accounting requirements in IAS. SKF is a Swedish bearing company with the head office in Gothenburg. The company is listed on Stockholm Stock Exchange and on NASDAQ, the US among others. In the US, SEC requires all foreign companies listed on a stock exchange to prepare their financial statements in accordance with US GAAP. Since SKF is listed both in the EU and in the US the company has to disclose the differences between SKF GAAP and US GAAP. SKF GAAP is the accounting principles SKF applies for the group's consolidated statements. SKF GAAP is a mixture between US GAAP and Swedish GAAP. SKF follows Swedish GAAP but tries to adjust their accounting towards US GAAP when this is allowed, in order to minimise the differences between the two GAAPs. Since SKF is listed on Stockholm Stock Exchange, the company is obliged to present financial statements in accordance with the standards issued by the Swedish Financial Accounting Standards Council. In order to do the consolidation the subsidiaries have to transform their local figures in accordance with SKF GAAP. These accounting procedures are stated in the manuals SKF Accounting Manual and SKF External Report Manual (SKF, 2002; SKF, 2000). Due to the EU proposal described above, SKF has to change its accounting principles that lead to changes in the manuals.

1.3 Research Issues

It is not clear how the adoption of IAS will affect the companies in different countries. Some authors state that companies in many countries within the EU, especially those countries with a local GAAP that is not particularly developed or where it quickly adjusts to international standards, will have no difficulties to prepare consolidated statements in accordance with IAS (Cheney, 2002). Some companies in these countries, including Sweden, believe that all they do now is consistent with IAS (Rippe, 2001).

Rippe (2001) on the other hand, argues that there is a great risk that companies in these countries, including Sweden, underestimate the effect of implementing IAS, which have not yet been transformed into local GAAP. Wilson (2001) supports this thought and believes that the IAS implementation problem will be huge for many European companies. This is because Europe is embracing a future for financial reporting that is not necessarily that widely known or

understood. Moreover the author argues that from an external perspective, it will fundamentally affect the way a company presents itself to investors. The financial statements will not only increase transparency, companies will also have to rethink how they measure performance and communicate with the markets since the measures such as earnings per share and other earning measurements will become increasingly volatile. The reason for this is that some accounts in the balance sheet will be stated at fair values instead of historical costs. Therefore, Wilson (2001) concludes, these earning measurements might even be meaningless as indicators of financial performance. Rippe (2001) argues that potential problem areas might be for example updating of instructions to subsidiaries and accounting technical updating. Further he states that the first step in preparing for the new EU directive is to make an analytical overview in qualitative terms about which areas will be most affected in the company's existing accounts. According to Hofste (2002), the conversion will particularly affect the areas of financial instruments and insurance contracts while the disclosure requirements will be extended to include more information on risk management and hedge accounting.

As has been discussed above, different authors believe the implementation of IAS for all listed companies within the EU will have different effects for the companies; there is no survey of the actual effect on a company. Another problem area is when the 'EU-company' is also listed in the US and therefore has to disclose the differences between US GAAP and IAS. For a company in this situation the harmonization of accounting standards within the EU will be complicated since they still have to prepare multiple sets of accounts and reports (Combarros, 2000; Gray et al, 2001). Thus, there will not be a total harmonization for the company since a disclosure to the US GAAP still has to be done. Due to these circumstances we find it interesting and relevant to make a deeper investigation in a multinational company listed on markets both in the EU and in the US.

The problem that will be addressed in this thesis is how the MNC's accounting principles are influenced by the implementation of IAS, when the company is listed both in Swedish and US stock exchanges and therefore has to follow both Swedish and US GAAP.

In order to find out which and how the accounting principles will be influenced, we have to explore what the differences are between the company's existing accounting principles and the principles that will be used after 2005. One might expect some accounting principles not to be affected at all, some to be totally deleted, and some to have minor changes.

1.4 Purpose

The purpose of this thesis is to compare IAS and SKF GAAP. Based on these assessed differences, implementation effects for SKF are analysed.

1.5 Scope and Limitations

As will be discussed in chapter 2 ,‘Methodology’, this is a case study conducted on one company. This limitation is made due to the fact that we have been given an assignment by SKF. Also, the amount of information involved in SKF's manuals will make the research very time consuming which prevent us from doing a quantitative research in the sense of several research objects.

Further the study is limited to explore the difference between IAS and the accounting principles used by SKF. We have only explored those differences that concern SKF.

The study only concerns the effect on the company from a group perspective; we have not explored the effect on the subsidiaries individual local statements, only the consolidated. Hence, we have looked on the principles from SKF's group accounting perspective since it is this department that gave us the assignment.

2 Methodology

In order to make the survey transparent and also to give the reader the possibility to make his/her own judgement concerning the quality of the result (Gill & Johnson, 1997), the method used in the thesis is described below. The chapter starts with the research approach, followed by the research perspective and the research method. After that a description of the case study is presented, the data collection method, and a discussion about the credibility in our study. Finally our research plan is disclosed.

2.1 Research Approach

Positivism and hermeneutics are two different sociological-scientific research traditions. They are two diametrically differentiated philosophies (Andersson, 1979).

Within natural sciences the scientists are often positivistic in their view on method even if theories are not considered as true or probable, but as abstractions with limited range. Their basic conception concerning positivism is the belief on rational knowledge. Knowledge shall be able to be tested empirically, and evaluations and estimations shall be replaced with measurements (Andersson, 1979).

The methods shall be able to produce knowledge where the reliance is high and the demand on the measurements is that they must not include systematic errors. In other words, the result must be the same each time. Also, the positivistic scientist must be objective and not be affected by his/her own set of appraisements. The knowledge shall be explained in terms of cause and effect relationships where the scientist tries to find a formal logic as a result of the measurements. The scientist can from these definitions and assumptions create his/her own theory as a base and test different hypotheses (Wallén, 1996).

The hermeneutics dismiss the scientifically ideal set be the natural scientists. Much of the interest today within the hermeneutics concerns psychology where the scientist tries to find an alternative to the positivistic approach. Hermeneutics is about interpretations of meanings in a broader view, where this interpretation is about understanding and uncoding these hidden meanings. Example of uncoding can be interpretations of different consequences, symbols and messages for understanding poems, art, and architecture (Wallén, 1996).

In this study, different texts have been read and interpreted, and this has been used as a base for interviews. Based on our understanding, pre-knowledge, ideas and thoughts these answers have been interpreted and analysed. Since both the interviewees' answers and our own subjectivity have affected the study, the hermeneutic approach has been used.

2.2 Research Perspective

A scientific approach explains how a researcher connects theory and empirical findings in the research process (Patel & Davidsson, 1994). Deduction is about using a theory as a base and make new studies that can lead to new theories (Qvarnström, 1982). To be able to reach a deductive conclusion, concrete experiences from everyday life are interpreted from a fixed frame of understanding (Andersen & Gambrup, 1994).

Under the deductive perspective, the approach uses existing theories and then draws conclusions about single phenomena. The existing theory decides which information is collected, how it is interpreted, and how the result is to be related to the theory. The validity shall be decided based on different theories, and therefore the empirical result should show that the theory holds (Johansson, 1993).

Inductive perspective means that the scientist uses observations from reality as a base, and tries to find regularities that can be summarised in theories. If the scientist is inductive she explores new phenomena and cannot plan the project in advance, where the choice of research object is a continuous process (Wallén, 1996). In this case the scientist first studies the reality in order to get as large perspective as possible. After that the theory is formulated. The purpose in using an inductive perspective is for the scientist to be able to develop his/her understanding about the whole phenomena, which is used as a research object. The research is more flexible and the scientist can choose methods of collecting data during the process (Patel & Davidsson, 1994).

Abduction uses empirical fact as a base, but does not dismiss the theoretical approach and is therefore closer to deduction. Abduction differs from induction respectively deduction by erasing the 'pure fact' approach which is based on empirical findings. Abduction means a single case can be interpreted by a hypothetical pattern that, if it would be real, explains the studied case. The abductive approach is a combination of the deductive and the inductive

approach. But it also adds a new component; during the process the empirical research object is altered and the theory is adjusted (Alversson & Sköldberg, 1994).

In this study, we have first compared existing accounting standards with new ones, and then analysed the consequences from different perspectives. Our approach was neither to build up a new theory nor to test an existing one, as in induction and deduction. Instead, the approach used in this thesis is a mixture where existing theory are studied and compared to the reality. This is appropriate since the theory and empiric is highly correlated and interrelated as we alter between these two items. We started with the comparison between the accounting standards, got ideas for theory, and then went back to the empirical findings for further studies. Finally, these findings were analysed with the theories used as a frame of reference.

2.3 Research Method

There are two different research methods, quantitative and qualitative, which are used when collecting, processing and analysing the gathered information (Merriam, 1988). The quantitative method focuses on the common, the average or the representative. The research objects must be able to be measured and the result must be able to be presented in numeric form. The quantitative method's issue is to choose which qualities to measure. Next problem is to decide how to measure, how to assess validity, and finally how to present the result (Eneroth, 1984).

The qualitative method is harder to define than the quantitative. The method consists of un-systematized and unstructured observation, like in-depth interviews or interview forms with no fixed questions- or answer alternatives. Scientist observes the phenomena by being present during the study. The emphasis in this type of research is that there is communication in two directions, and closeness to the research object (Andersen & Gambrup, 1994). According to Merriam (1988) a lot of the characteristics that distinguish the qualitative research are also distinctive for case studies. When applying the qualitative research the aim is to understand the significance of a particular phenomenon or experience.

We have explored the differences between IAS and SKF GAAP and the consequences of the implementation of those IAS, which is a qualitative

approach. The selection in a qualitative research is small and not random. The selection of our research was small since it only consisted of one company, SKF. The qualitative approach was appropriate in this study since it gave us much information regarding the research object, which gave us information about a particular phenomenon. Further, our aim was not to measure the research objects and the result is not presented in numerical form, as it is in the quantitative method.

2.4 Case Study

Case study means a survey that incorporates a few cases that are studied carefully. The case study can be used for formulation of hypothesis, developing theories, exemplify and to illustrate (Lundal & Skärvad, 1992). Merriam (1994) considers a case study, especially if it is a qualitative one, to be a suitable method to use in order to understand and interpret observations in sociological phenomena.

A case study can be conducted in many ways. The scientist can use interviews, observations or document as information sources (Merriam, 1994). The advantage of a case study is that it gives an interrelation between the scientist and the research object, which can form a base of understanding between the two parties. If the scientist uses an interpretative approach, there are good possibilities describing the interviewees' basic conceptions, which can form a basis in communication. The case study gives the researcher a possibility to be acquainted with the interviewees, which might help the communication between the parties (Norén, 1990).

A case study is the research approach that has been chosen because it can answer our 'how' question. Yin (1994, p.13) states that; *"In general, case studies are the preferred strategy when 'how' or 'why' questions are being posed, when the investigator has little control over events, and when the focus is on a contemporary phenomena within some real-life context"*. In order to make comparisons and analysis of the different principles, our study had to answer the question 'how' the company is affected when IAS is implemented in SKF. More specifically, we wanted to assess the differences between the accounting principles used by SKF, and the IASB's accounting standards.

The drawback with case studies is that since the material is created with a specific purpose, it is very hard to control whether the data has been interpreted

correctly. There is also a problem of objectivity, both from respondents and from the scientist (Andersen & Gambrup, 1994).

2.5 Data Collection

The data that are collected for a survey can be categorised into two kinds of data; primary and secondary data (Patel & Davidsson, 1994).

2.5.1 Primary data

Primary data are those collected directly by the researcher, for example observations and interviews (Patel & Davidsson, 1994). When performing interviews the scientist can choose to use open questions. One argument in support of open questions is that it is like having a conversation, where the respondent is not forced to answer with some specific formulations, which might be considered strange by the respondent. Another advantage in using qualitative interviews is that it is easy for the scientist to ask the respondent to explain the answers. A drawback can be that the interviews are more complicated and take a longer period of time (Halvorsen, 1992).

In this study, comments on the comparison between IAS and SKF GAAP were received and interviews were conducted with the accountants in SKF. We chose to conduct semi-structured interviews since we decided in advance what questions to ask the respondents. The answers were then used for further questions like; ‘Can you explain that further?’. We used open questions where the respondents had the possibility to answer in any way. These interviews were based on an interview guide that was based on the theoretical chapter.

We conducted the interviews by visiting the company, which gave the interviews a controlled impact where the respondents feel safe. This gave us the possibility to use complicated questions (Wiedersheim & Eriksson, 1997).

The interviews were taped. By doing this we made sure that everything said during the interviews were accessible for analysis. Disadvantages with the use of a tape-recorder are defects in the technical equipment and the respondent’s insecurity when being taped (Merriam, 1994). We did not experience any of these disadvantages. The taped interviews were written down word by word. The use of tape recorders was very time consuming, though according to Merriam (1994) this gives the best base for analysis.

2.5.2 Secondary data

Secondary data are all forms of secondary information that are available in some documented form, like books and magazines. Secondary data is information that does not come directly from the research object, but have been interpreted by other external sources. The drawbacks with secondary data is that it can be old, and it can be affected by another writer's opinions and judgments without this being apparent. The advantages of using secondary data are that it can save time and it is less expensive to collect (Wiedersheim & Eriksson, 1997).

In order to assess the differences between IAS and SKF GAAP, the data that have been used are documents from SKF. These documents include SKF External Report Manual (SKF, 2002), SKF Accounting Manual (SKF, 2000), SKF Annual Report 2001 (SKF, 2001), and SKF's website. Further we have used standards released by the IASB, the Swedish Financial Accounting Standards Council, and the FASB. Hence, chapter 6 'Comparison between IAS and SKF GAAP' includes a lot of document studies. The argument to use documents is supported by Yin (1994) who states that in some case studies the major part of the data used are documents.

2.6 Discussion of Credibility

According to Merriam (1994), all research aims to produce result with validity and reliability in ethically acceptable ways, which means that the demand of the quality of the information is high. The research report should give a 'true and fair' picture of the reality, which means that the result must be credible and trustworthy. It is also of great importance to strive for accuracy and objectivity.

2.6.1 Validity

Validity can be defined as availability and with the absence of systematic error (Abnor & Bjerke, 1994). There are two types of validity – internal and external.

2.6.1.1 Internal Validity

It is hard to be totally correct in a study, so it is very important to continue looking for mistakes (Yin, 1994). In this study the validity is high since specific details have been taken into consideration that concerns the specific case. Information has been received through detailed studies of IAS, FAS, SKF GAAP, SKF's annual reports, and interviews. These sources contribute to a high inner validity in the conducted study.

2.6.1.2 External Validity

External validity describes how well the internal validity can be transferred onto other situations, where the case studies are often described as not being able to generalize (Arbnor & Bjerke, 1994; Yin, 1994). This means that it can be risky to have one specific research object as a base and then transfer conclusions to other research objects. The advocates states that the contribution from the case studies is to give the science new ideas but these ideas must then be analysed in a 'real' quantitative survey (Lukka & Kasanen, 1995). From this perspective, this study must therefore be complemented with a quantitative study that analyses how different companies are affected by IAS implementation in order to reach higher external validity. Lukka and Kasanen (1995) on the other hand, give reasons why it is possible to draw generalizable conclusions from high quality case studies; *"...we argue that both case and statistical studies face the same obstacle of justifying real induction, and both approaches, if conducted properly, have a chance of producing results that are generalizable to some extent"* (Lukka & Kasanen, 1995, p.85).

2.6.2 Reliability

Reliability means that if the result from a study can be repeated, i.e. if the research was done one more time the result would be the same (Merriam, 1994). High reliability in the research has the characteristics of not being influenced by the researcher. There are different ways of testing the reliability of a study and control the data that has been collected. For example, the study can be repeated several times, a so-called re-test. Another way is to conduct two parallel tests at the same time (Abnor & Bjerke, 1994). Since our method is clearly presented and since our case study is clearly described, the reader can form his/her own opinion and interpret the conducted study and the analysis, which increases the reliability in the survey.

2.6.3 Restrictions by SKF

Restriction regarding the information disclosed in the comparison between IAS and SKF GAAP were set by SKF on this thesis. SKF does not want certain information to be published. For example information that might be used as 'inside information' is not published. Hence, the answers received by SKF's accountants during the interview were restricted. These restrictions will definitely have an effect on the credibility of the thesis.

2.7 Research Plan

We started by carrying out a literature review, consisting of SKF's accounting manuals, the IASB's and the FASB's accounting standards. This literature is further described in section 6.1. The literature review gave us a tool to explore the differences between IAS and SKF GAAP, which are presented in chapter 6 'Comparison between IAS and SKF GAAP'. After this comparison the theoretical frame of reference was carried out, consisting of the following areas: chapter 3 'International Accounting Standards' and chapter 4 'Organisational Change'. The theoretical frame of reference as well as the differences assessed in the comparison was used as a base when interviewing accountants at SKF about implementation effects for the company. The result of the interviews is disclosed in chapter 5 'SKF and the Implementation Process' 'Comments by SKF' and in chapter 6 'Comparison between IAS and SKF GAAP'.

Finally, all parts in theoretical frame of reference and the empirical findings where analysed and conclusions where drawn. The analysis and the conclusions are disclosed in chapter 7 'Analysis' and chapter 8 'Conclusions'.

3 International Accounting Standards

Since the purpose of this thesis is to analyse the implementation of International Accounting Standards Board's accounting standards, a description of the organisations' history and structure is presented. Finally there will be a discussion about harmonization, implementation effects and materiality.

3.1 The IASB

There are many players in the game of accounting harmonization, though according to Most (1994, p. 3-14) *"the principal instrument of the accountancy profession for its achievement is the IASC"*. International Accounting Standards Committee (IASC) was established in 1973 by accountancy bodies in Australia, Canada, France, Germany, Japan, Mexico, the Netherlands, the United Kingdom, Ireland and the United States of America (IASB, Website). By 2001 the organisation had a membership of 143 accounting bodies in 104 countries (Gray et al, 2001).

In the beginning the IAS allowed substantial flexibility to accommodate different national interests, although the last decade there has been a pressure to develop more uniform standards to facilitate cross-border capital raisings and stock exchange listings. In cooperation with the International Organization of Securities Commission (IOSCO) a core standards program to promote the development of more uniform and high-quality standards was completed in 1998 (Choi et al, 1999; Gray et al, 2001).

In January 2001 International Accounting Standards Board (IASB) replaced its predecessor international standard setter, the IASC. The IASB was created after that IASC's structures and processes were reviewed, in order to better prepare the organisation for the future of international accounting standard setting. Up until 2001 IASC was the central point for international accounting standards, where the purpose of the organisation was to develop a set of central international standards that would be acceptable international for cross-border securities listings. The new organisation of the IASB has the same characteristics as the FASB (FASB, Website), and the meetings of the IASB to discuss technical issues are open to the public.

3.2 The Structure of the IASB

The IASB is a standard setting body based in London, UK, that is independent and solely privately funded. The mission of the IASB is to develop "...a single set of high quality, global accounting standards that require transparent and comparable information in general purpose financial statements" (IASB, 2002a, p. 1). In order to achieve convergence in accounting standards around the world the IASB cooperates with national accounting standard setters (IASB, Website). The members of the board come from different countries and these members have a variety of functional backgrounds. The IASB has liaison members of the board whose purposes are to maintain close contact with respective liaison member's national standard setters. Since these liaison board members ensure communication between the national board and the IASB about each other's agendas, these liaison members are responsible for the fact that the new IASB and national bodies are working toward the goal of convergence on a single set of high-quality standards around the world (IASB, Website).

The following entities are included in the IASB (IASB, Website):

- *IASC Foundation* - consists of trustees responsible for, among others, appointing the members of the IASB, the International Financial Reporting Interpretations Committee and the Standards Advisory Council.
- *The Board* - establishes and approves standards.
- *International Financial Reporting Interpretations Committee (IFRIC)* - interprets accounting issues that can lead to conflicting or improper treatment in the non-existence of reliable guidance.
- *Standards Advisory Council (SAC)* - advises the Board on agenda decisions and priorities in the Board's work.

The IASB has so far approved forty-one international accounting standards, and according to Gray et al (2001), the standards have gained acceptance by many stock exchanges around the world. Also, according to the IASB many countries endorse IAS as their own either without amendment or with minor additions or deletions. Furthermore, many leading enterprises have stated that they prepare their financial statements in accordance with IAS (IASB, Website).

3.3 Harmonization

Harmonization appears to mean different things for different people. Some people see harmonization as complete standardisation while others see it as a process on increasing the compatibility of accounting practises by setting a limit of how much they can vary (Mathews & Perera, 1996). However, many authors distinguish between harmonization and standardisation. Choi and Mueller (1992, p. 257) state that harmonization means that: “...*different standards might prevail in individual countries, so long as they are ‘in harmony’ with each other – meaning they should not logically conflict*”; while standardisation “*means that a single standard or rule is applied to all situations*”. This is in line with Tay and Parker (1990, p. 18) who see harmonization as “*a movement away from total diversity of practice*” and standardisation as “*a movement towards uniformity*”.

Most (1994, p. 3-14) distinguish between three distinct, though related concepts:

- “1. *Uniformity, the elimination of alternatives in accounting for economic transactions, other events, and circumstances.*
2. *Standardization, the reduction of alternatives while retaining a high degree of flexibility of accounting response.*
3. *Harmonization, the reconciliation of different accounting and financial reporting systems by fitting them into common broad classifications, so that form becomes more standard while content retains significant differences*”.

Most (1994) further states that the arguments for harmonization rarely distinguish between these separate concepts.

3.3.1 Arguments for harmonization

Some arguments for harmonization of accounting standards are:

- *Improving comparability of international financial information* - Analysts, investors and other external users of the financial statements will benefit from this comparable information when making investment decisions (Turner, 1983; Carey, 1990; Wyatt & Yospe 1993; Mathews & Perera, 1996).
- *Saving time and money for enterprises when preparing financial statements* - A number of financial, strategic and commercial advantages

motivate enterprises to seek equity listings on foreign stock exchanges. However, the difference in regulations and listing requirements of various stock exchanges forces the enterprises to prepare multiple sets of financial statements which are very time and money consuming. Furthermore, enterprises with subsidiaries situated in foreign countries will save significant amounts of time and money if they can reduce the number of adjustments they have to make to the subsidiaries accounts before including these in the consolidated accounts (Turner, 1983; Carey, 1990). Another advantage with harmonization for enterprises is that it will be less costly to raise capital on foreign markets (Wyatt & Yospe 1993).

- *Raising the general level of accounting practice throughout the world* - Uniform accounting standards will make a contribution to the level of accounting standards worldwide. Harmonization requires a minimal level of reporting, so the level of accounting practise in many countries will have to rise (Turner, 1983).
- *Enhancing international capital flows* (Mathews & Perera, 1996).
- *Facilitating social control over the global corporations* (Mathews & Perera, 1996).
- *Avoiding duplications of research efforts* - Standard setting bodies may avoid research and standard-setting efforts by adopting internationally accepted standards (Blake & Hussain, 1996).

3.3.2 Arguments against harmonization

Some arguments against harmonization of accounting standards are:

- *Different national circumstances, legal systems, economic development and cultural differences* - International standards cannot possibly provide for the wide range of national circumstances, legal systems, stage of economic development and cultural differences. These differences will always exist, thus the harmonization of accounting standards in different countries will tend to fail, that is international standards will never be flexible enough to handle these differences (Rivera, 1989; Blake & Hossain, 1996; Choi et al, 1999).
- *Accounting imperialism* - There is a fear that some countries will dominate the production of international accounting standards and pay no attention to the needs of the rest of the countries (Blake & Hossain, 1996; Rivera, 1989).

- *Standards overload* - International accounting standards may create 'standards overload', meaning that enterprises are hard pressured when they have to comply with additional complex and costly international requirements except for the high level of national, social, political and economic pressure they already have to respond to (Choi et al, 1999).
- *Tactic for large accounting firms* - International accounting standard setting is a tactic for large accounting firms to expand their markets. Only the large international accounting firms are situated to meet the demand of international standards (Choi et al, 1999).

3.4 The Effect of the Implementation of IAS

The creation of the IASB is the adoption by the accounting profession's goal of trying to harmonize accounting and financial reporting (Most, 1994). Therefore a company with subsidiaries situated in foreign countries should find itself saving significant amount of time and money due to reduced number of adjustments they have to make to the subsidiaries accounts before including these in the consolidated accounts (Turner, 1983; Carey, 1990).

Rippe (2001) thinks there is a great risk companies within EU underestimate the effects of implementing IAS, since these accounting standards not yet have been transformed into local GAAP. In addition, Wilson (2001) believes that the IAS implementation problem will be very difficult for many European companies since the implementation effects of IAS is not that generally known or understood. According to Greco (1999) FASB delayed its implementation of FAS 133 one year when companies experienced problems since they needed more time to modify their information systems and educate their managers about the changed accounting standard.

The companies will also have to increase their communication to the market since the financial statements will both be affected by increased transparency, and also increase volatility in earnings due to fair value measurements instead of historical costs in the balance sheet. This will require the companies to be more specific in their communication to the market, in order to explain these changes in earnings (Wilson, 2001; Hofste, 2002).

3.5 Materiality

The IASB states that *"information is material if its non-disclosure could influence the economic decisions of users taken on the basis of the financial*

statement” (IASB 2002a, p. G-23). According to the IASB (2002a) the materiality is depending on the size of the item or error judged in the particular circumstances of its omission or misstatement.

Hendriksen and van Breda (1992) argue that materiality is very similar to the concept of relevance. The concept of relevance implies that all information that may assist in the prediction of the types of information necessary in a decision making process or that may assist directly in the decision-making should be presented. The authors continue by stating that information may be material if the knowledge of this information may be significant to the users of accounting reports.

Materiality places a restriction on what should be disclosed, meaning that too much data can be just as misleading as too little data. When too much data is presented the reader has difficulties in distinguishing the relevant data and decision may be based on inadequate data (Hendriksen & van Breda, 1992). According to the authors materiality may be related to the significance of value changes and these changes should be considered material if they are significant or large enough to influence the decisions of the users of financial reports.

Hendriksen and van Breda (1992, p. 144) give types of items where materiality may be involved in the decision to disclose or not:

- *“Quantitative data, such as items affecting net income and asset valuation.*
- *The extent of aggregation or itemization of quantitative data in the formal statements.*
- *Quantitative data that cannot be estimated accurately enough to be included in the statements.*
- *Quantitative features that must be disclosed by descriptive phrases or sentences.*
- *Special relationships between the firm and particular individuals or groups affecting the rights and interests of other individuals or groups.*
- *Relevant plans and expectations of management”*

4 Organisational Change

Since the process of the implementation of IAS on a multinational company is an 'amendment' of that company, the consequences in terms of organisational change will be discussed in this chapter. The chapter starts with a discussion about strategy and origin of a change, followed by the human factor in accounting, different reasons for resistance within the organisation, and how to facilitate the change. Finally we will end up with the accounting system and a strategy of the implementation of accounting standards.

4.1 Strategy of Change

Changes can be of different types; minor shift, new mission, or new operating procedures. Whatever the characters of the changes are, the way the changes are managed will determine if these will be embraced by employees and therefore if these changes will give positive results to the company (Besecker, 2001).

A company's success is highly correlated with its ability to cope with different changes that the company constantly is exposed to. Even though there is increasing tempo of changes, there are many different causes of those changes (Wilson, 1992). These changes can be either internal, as when a decision is made by the management to change depreciation rate of fixed assets but which stays within the allowed interval set by accounting regulators, or it can be external change as when new accounting standards are imposed by legislation.

Although it is human nature to resist changes, companies cannot avoid them (Besecker, 2001). Both organisations and employees are more and more forcing changes into the one who is carrying out the work, and also forcing changes in how the work is organized and managed (Leana, 2000). Simultaneously, there are several organisational, individual, and societal forces trying to stabilise the work. In this situation a natural friction between stability and change is a natural part in an organisation.

4.2 The Origin of a Change

Wilson (1992) separates changes into planned versus emergent change processes. The planned changes are characterised by those processes in which there is a smooth transition from some previously state, towards a future desired state. This means that from a parent – subsidiary perspective, it is

important to communicate the change towards the subsidiaries, in order to get acceptance from the subsidiaries. Examples of reasons for resisting a change can be an individual's fear of failure, lost of status based on unique knowledge about a subject, and fear of the unknown. The author also declares that for the parent company to develop the right condition for a change, it is important to identify these forces that might resist a change. Afterwards, when the change is completed, a balance between those forces that encourage and those forces that resist the change should be created.

On the other hand, emergent change process is characterised by an unknown phenomena and the cause of change is often due to reasons beyond the organisation. These reasons for the change can be for example economical or political where there are demands on the company to adjust for these changes, for example changed legislations. Wilson (1992) argues that it is easier for the organisation to accept these external changes, since these changes can be regarded as more necessary.

Acher (1998) states that any major change carries the expectation of success for the organisation, but reveals statistics suggesting that up to 80% of change programs fail to achieve what they set out to do.

4.3 The Human Factor in Accounting

Since accounting is a social science, no reliability of accounting concepts or standards or of the financial statements that are based on them, can be completely without considerations of the pervasive influence of human nature on them (Bernstein, 1993). According to the author, people who are gathering financial data all too often face a deliberate attempt to hide information. In other words, financial statements are frequently based on evasive data and even deliberate lies. Lies can arise from fear of tax authorities, from dislike of government interference, or from the desire to mislead competition, inside or outside the company. Managers or individual executives in an enterprise may want accounting presentations to enhance the compensation, to reflect favourably on their operating performance, or their own egos. With a strong personal interest at stake, these managers or individual executives will continue to try to bend the theory so that the practice favours their own more narrow interest.

Hopwood (1974) argues that social and human factors are vital aspects of the design and operation of any accounting system and that any attempts to deal with accounting matters in isolation from their human context must of necessity run into difficulties. Accountants searching for means of understanding and improving standard setting must therefore see the process in its entirety and respond to it as a complex human and technical problem rather than one standing in technical isolation since technical and social factors have no separate existence. Even at the narrow level, we need to recognise that accounting procedures are themselves human responses to organisational problems. If we recognise that accounting systems operate in human organisations, that they serve human purposes and that they ultimately have behavioural objectives, then their behavioural and social aspects can never be realistically considered as mere trimmings on the underlying technical structure. Viewed in this way, accounting is about human behaviour according to the author, and its social and behavioural aspects are just as much an indispensable part of the whole as more traditional technical aspects.

4.4 Resistance

Since, as was mentioned above, a change is often met with resistance, it is important to understand reasons for resistance in order to be able to counteract this resistance. Some of the most important factors for resistance stated by Erikson (1992) are:

- *Habits are disturbed* - Since many individuals seek safety in a job, unknown future might be difficult for them to cope with.
- *Established social networks are splintered*
- *Unclear and insecure future* - Since changes are often implemented top-down, employees might be insecure about their position under the change period.
- *Concern about ones own competent level* - Since a change might cause an individual to get new or changed working tasks, many individuals might be worried not having the right knowledge or not be able to acquire the knowledge fast enough.
- *No possibility to affect the change* - If an individual has not been included in the decision process, there is a risk that individual might not feel seriously committed conducting the actual change.
- *Too little knowledge and/or background information behind the reasons for the change*

Tullberg (2000) also has some conclusions regarding consequences of implementation of changes. In a change programme imposed from the top there are numerous factors that cause anxiety in the organisation. The examples provided by the author are loss of control, fear of future positions, loss of knowledge about the location of power, external pressure and conflict about the means for achieving the goals. Also, if top management, or parent company, brings in and pays extra resources such as internal or external consultants, this is likely to be perceived as just more pressure and as bringing management too close, and thus to become another source of anxiety. The author also states that growing concern in an organisation creates a need to defend oneself and to divert the concern down to the steady state, which evokes regression to the old one. In this situation, instincts for defence and the unconscious adoption of well-known and familiar behavioural patterns and thought styles are a likely result.

Erikson (1992) continues stating that since the need for safety is extra large during processes of change, it is very important to emphasise continuity. At the same time the management, or the parent company in a parent-subsidary relationship, must carefully explain the importance in the proposed changes. Since the management often is way ahead of the effected part of the organisation (i.e. the subsidiary) regarding a specific change, the author states there is a risk the two parts will talk about different things and not understand each other. The resistance is normally most comprehensive in the beginning, since many individuals are trying to maintain the old and to make as small adjustments as possible, trying to make the change not affecting them. Also, sometimes it is enough making passive resistance, the individual conducting the tasks in the old usual routine. It might be easy to forget or purposely misunderstand a change.

Björk et al (1973) analysed the implementation of an organisational change. The authors' conclusion is that the implementation took a considerable long time to conduct, there were implementation problems, the expectations were very high in the beginning, the trust between the involved parties was not good, and the implementation team did not always work in the same direction. Furthermore, the dynamic effects from the involved individuals in terms of insecurity, fear, disappointment, trust, and satisfaction, were much larger than the authors first expected.

By threatening or by demonstrating energy and exerting pressure, it is possible to bring about changes in formal structures, in figures and systems (Tullberg, 2000). But, the author finally concludes, it is very difficult to make changes in the structure of the ongoing processes, in the institutionalised behaviour and thought styles.

4.5 To Make the Change Easier

According to Besecker (2001) there are four factors to focus on in order to make a change successful: the definition, the planning, the communication, and the implementation of the change. Organisational change should result from a need and should result in a defined product, and the process should begin with an analysis of that need. Managers shall also form a vision of the future expected to result from that change. All major changes must be carefully analysed within the business entire environment as organisational impacts, resource requirements, and personal and professional impact on those involved.

The critical part as regards planning is to plan and implement changes in the most collaborative and least disruptive method. Beginning with the basic outline of who, what, when, where, and why of the plan, will permit quick development of a comprehensive plan. Besecker (2001) argues that one single individual should not carry out the whole planning process and especially more complex undertakings should involve several individuals. On the other hand, managers must also guard against getting too many people involved in the planning of a proposed change since this might disrupt the implementation. In this situation, the change may not take hold if the proposed change does not proceed past the planning process in a timely manner. Therefore, one of the most crucial aspects of planning is to identify and assign specific responsibilities, where the crucial responsibilities are the leader, change agents, and members of the leadership team. The leader of a change process is the individual sponsoring the change, while the change agents are the ones in charge of recommending how the organisation might achieve the goal set by senior management. Finally, the leadership team is in charge of providing resources, moral support, and communication assistance throughout the organisational change.

Positive behaviour will produce positive results in others, but if the leadership is negative and unsupportive then the people will not follow. Since everyone

will not initially support the change, it is important to identify 'early adopters' who will support the change within the organisation (Acher, 1998).

With the purpose of making involved individuals supportive of the changes, these individuals are to be kept well informed. Consequently, even at the very earliest stage of the process, communicating the reasons for changes and the desired end result in writing and distributing that document to all staff will help persuade employees that the conception has been thoroughly analysed. Continuously, the progress should then be communicated in terms of any further proposed changes. This should be done in order to avoid hearsays and rumours, which can arise if changes are planned behind closed doors since the information is distributed only when the new procedures are near implementation (Besecker, 2001).

According to Björk et al (1973), it is very important that the different parties are involved and engaged during the implementation of a change. The authors conclude that if an implementation process of a change shall be successful, it is very important that the individuals who are affected by the change feel they can influence and that they have responsibility during this process.

This implementation is smoother if the previously three steps are conducted properly. However, circumstances may change and demand activities other than those originally planned. Thus, leaders must adjust the plan as each stage progresses. Organisational change does not happen without problems, since most people are naturally averse to change, so resistance is to be expected. Besecker (2001) concludes that resistance can be minimized if concerned individuals are brought into the process from the beginning. Thus, these individuals can see why the change is needed, how the change will be accomplished, and how the company and the staff will finally benefit from the change.

Acher (1998) states it is very important to emphasize that change and the process of change depends on leadership from the top, and without a leader and without leadership little or no progress can be made. The author also concludes that effective leadership combined with robust internal and external communication is how to make a successful change complete.

4.6 The Accounting System

The relationship between accounting and external change is far from straightforward. Therefore it may be dangerous to present a strong theory of how external changes react on internal operations and changes (Hopwood, 1987). Nevertheless, Granlund (1998) concludes in a case study of the interplay between management accounting, change and stability, that accounting systems are seen as stable institutions and therefore difficult to change. According to the author the most important reasons for the institutionalisation of the accounting system are:

- *General project-operation* - Top management lack of continuous support and enthusiasm.
- *Cultural reasons* - Due to institutionalised, established routines changes are difficult to conduct.
- *Individual/social resistance* - No matter the outcome of the change people will resist that change since this will be more uncertain than present situation. This is because people typically prefer routine-like conditions that enhance feelings of security where people know how to create positive visibility.
- *Accounting acting as a baseline for executives in organisational processes of change* - Managers need a baseline against which to measure the alteration when everything else is changing.
- *There is satisfaction with the existing accounting system* - If there are shortcomings with the present accounting systems, informal accounting procedures and practices are developed outside that system.
- *Technical complicated accounting system* - Accounting systems in large organisations are very difficult to change since these accounting systems are often very complex and centralised and maintained by many accountants, who may be happy with the existing system or do not have time to develop the system.
- *During period of crises, companies often lack time, money, and people*

4.7 Implementation of Accounting Standards

Implementation of new complicated accounting standards is a very difficult task for accountants. Dennis (1999) suggests a step-by-step approach that helps accountants analyse and anticipate the impact of new guidance.

4.7.1 Assign monitors

Specific groups or professionals should be designated to monitor and translate new financial reporting guidelines and other pronouncements. These accounting policy groups monitor new standards and decide how to implement them, which makes these group members familiar with the standards through the exposure drafts (Dennis, 1999). Also, Smith (1982) suggests a procedure when implementing a new accounting standard, which should start with a careful study of the exposure draft.

Recommendations are then provided from the accounting policy group about accounting treatment for transactions, consultation on financial reporting matters and participation in projects with financial statement implications. Staying informed about the standards should actually be the simplest job for the accountant. The tough job is to translate and sometimes justify a pronouncement's impact, which involves determining the potential effect of the standard and creating an implementation plan (Dennis, 1999).

4.7.2 Analyse effects

After the company accounting policy group has studied a standard, they assess if the standard will have a significant impact on the company. If a standard is expected to affect operations at the company, the task to analyse possible effects should be assigned to a project manager within accounting policy group. That accountant circulates a summary memorandum to a liaison group in each of the company's business groups and core areas. The liaison group should be financial professionals who are involved in areas such as financial reporting or planning but who may not be involved in accounting theory to the same extent as the accounting policy group. The liaison group reports back to the project manager on how a standard may affect a particular area or operation, where the amount of internal information that is necessary to gather of course depends on the standard. Sometimes these feedbacks from other departments will show how non-financial managers react to a standard. Therefore, in order to assist the implementation of a standard, it is important to measure not only how well other internal users will understand the accounting but also to understand how they will react to the logic of the standard and the consequent effect on the operations of the company (Dennis, 1999; Smith, 1982).

4.7.3 Summarize technical details

To support understanding, available information about new accounting guidelines should be spread throughout the company. In addition, the accounting policy group creates its own written draft summary about the expected impact on the company. This summary offers observations and explanations specific to company operations, where the summary should be sent directly to the CFO level (Dennis, 1999; Smith, 1982). If a standard for example allows some choices in application methods, the summaries might comment on which are best, based on the previous discussions with people in affected parts of the organisation. The paper should also include a summarised proposed adoption plan.

After creating a draft summary, comments from company liaisons, the company's external auditors etc., are received and the paper is adjusted if the comments have a more appropriate alternative (Dennis, 1999; Smith, 1982). When completed, the accounting policy releases are published in the accounting policy database or similar.

4.7.4 Assess impact

Some accounting standards are without trouble integrated into a company's financial reporting systems, while other standards require changes that will cost time and money. Once the information is gathered about effects in various areas, accountants should try to understand the standard's broader impact (Dennis, 1999).

4.7.5 Gain acceptance

To ensure that the implementation is done accurately and efficiently, an important step according to Dennis (1999) is to work with the executives throughout an organisation. Accountants are frequently expected to be defender for accounting standards. Despite efforts to prepare and educate non-financial colleagues, these colleagues often question the logic of the standards and the accountants have to explain theory behind the standard. Management encouraging an ongoing dialogue between the accountants and others in the company can solve the problem. In order to gain the non-financial colleagues acceptance, external auditors can provide with reinforcement with their resources and experience in practice, which can help gaining better internal understanding of the accounting standards.

5 SKF and the Implementation Process

This part of the thesis starts with a brief description of SKF and its accounting principles, followed by a description of SKF's 'Group Accounting and Reporting' department. Finally, the implementation process at SKF is discussed.

5.1 The Company

SKF is a Swedish bearing company with the head office in Gothenburg. The company was founded in 1907 and from the very beginning focused intensively on quality, technical development and marketing. SKF is a global supplier of products, solutions and services in the rolling bearing and seals business, where the focuses are on technical support, maintenance services, condition monitoring and training. Furthermore, SKF is in the market for linear motion products, as well as high precision bearings, spindles and spindle services for the machine tool industry, and is an established producer of rolling bearing steel. SKF has subsidiaries in 46 countries, 83 production sites in 24 countries, and around 40000 employees. The company has its own sales companies, supported by distributors and dealers, its e-business market places and global distribution system (SKF, Website).

The SKF business is organized into five divisions: Industrial, Automotive, Electrical, Service, and Aero and Steel. Each division serves a global market, focusing on its specific customer segments. There are five staff units: Group Legal, Group Communication, Group Finance, Business Development and Purchasing, Group Quality and Human Resources, and Group Technology Development (SKF, Website).

5.2 SKF GAAP

Since the company is listed, among others, in Sweden and in the US, SKF has to prepare its financial statements in accordance with both Swedish GAAP and US GAAP. Therefore, SKF discloses the differences between SKF GAAP and US GAAP in the annual report. SKF GAAP is the accounting principles SKF applies for the group's consolidated financial statements. SKF GAAP is a mixture between US GAAP and Swedish GAAP. SKF follows Swedish GAAP but tries to adjust their accounting towards US GAAP when this is allowed, in order to minimise the differences between the two GAAPs. Since SKF is listed on Stockholm Stock Exchange, the company is obliged to present its financial

statements in accordance with the standards issued by the Swedish Financial Accounting Standards Council. In order to conduct the consolidation, SKF's subsidiaries have to transform their local figures in accordance with SKF GAAP where these accounting procedures are stated in the manuals SKF External Report Manual and SKF Accounting Manual (SKF, 2002; SKF, 2000).

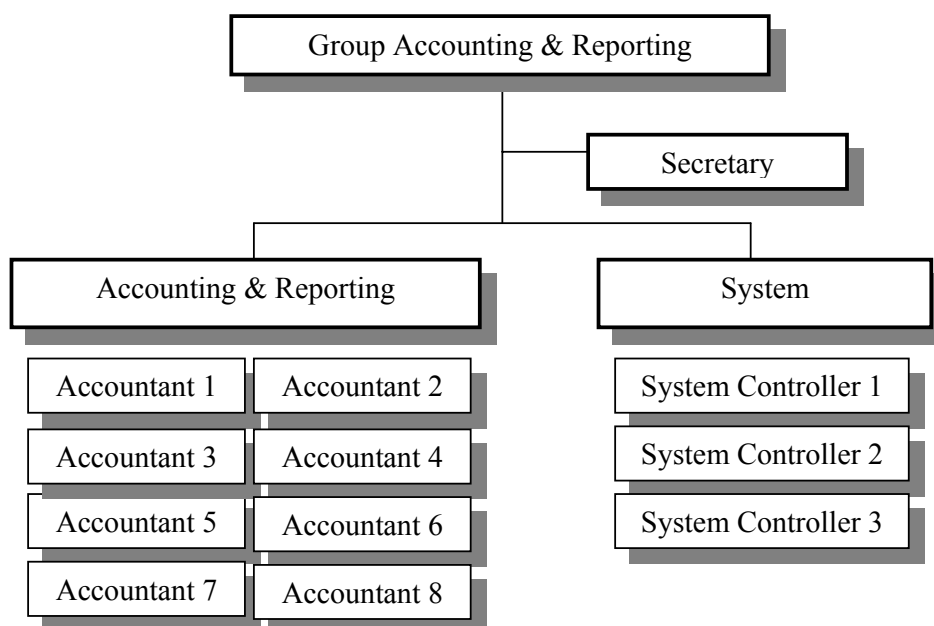
5.3 The Group Accounting and Reporting Department

During an interview with one of the accountants at SKF's 'Group Accounting and Reporting' department, the information for section 5.3 and section 5.4 was collected.

5.3.1 The organisation

The department responsible for the group's consolidated financial statements is the 'Group Accounting and Reporting' department, which is a department within 'Group Finance'. 'Group Finance' has several other departments, which are engaged in taxes, treasuries etc. The 'Group Accounting and Reporting' department is divided into two subgroups, which is presented in Figure 1. 'Accounting & Reporting', consists of eight accountants, and 'System' consists of three system controllers who are responsible for SKF's accounting computer system.

Figure 1: Organisation



5.3.2 Responsibilities

The main responsibilities for the ‘Group Accounting and Reporting’ department are:

- To close the books for the divisions and the group
- To evaluate and define SKF GAAP
- To recur reporting of financial information to group and division management, the external market, and the Department of Commerce in the US
- Systems and processes that support accounting and reporting processes

The ‘Group Accounting and Reporting’ department is responsible for the following processes:

- *Monthly and yearend closings for the group and the divisions* – The department is responsible for consolidating the reporting according to legal structure and operational structure.
- *Financial reporting to the market* – The department is responsible for the financial information included in the reports for the SKF group.
- *Accounting policies for the group* – The department works to large extent with the accounting policies for the group, which is SKF GAAP.
- *Accounting and reporting instructions* – The department is responsible for issuing accounting and reporting instructions to the units within the group. These instructions are found in: Accounting Manual, which describes how to account and focuses on certain important issues and elucidates these; External Report Manual, which describes what to report; GMS Manual, which describes how to use the reporting system. The manuals are the tools for the accountants at the department.
- *Sales statistics reporting* – The department is responsible for the sales statistics reporting in terms of the quality of the figures, the concepts and the access to reports.
- *Performance standard and standard cost calculations* – The department is responsible for setting standards for performance standard calculation and standard cost calculation.
- *Group management system* – This is the system used for reporting financial information to ‘Group Finance’. All subsidiaries put their figures into this system. The ‘Group Accounting and Reporting’

department then collects these figures and creates reports and consolidates the entities.

- *Group management data warehouse* – In this system the department adds the information collected in the group management system, which then could be viewed on the intranet by, for example, the Chief Executive Officer.

The department communicates its knowledge through the manuals and through education. The education is above all intended for newly employed but also for employees changing working area within SKF.

5.3.3 Consolidation of subsidiaries

When consolidating the subsidiaries the department uses the external reports, described in the External Report Manual. By the reports the department collects all information needed, which is rather comprehensive. In the monthly reports the subsidiaries have four days to put together the financial data to be reported in the group management system. On the fifth day the department starts the consolidation process. All internal transactions are eliminated. The process of making these eliminations are divided among the accountants in order to speed up the process. By the end of day five the department finally consolidates the financial statements for the group.

5.4 The Implementation Process of IAS at SKF

5.4.1 Organisation

All accountants at the ‘Group Accounting and Reporting’ department are involved in the implementation of IAS, but the level of involvement differs from person to person. Also the system controllers are involved since changes made in the accounting principles will lead to changes in the accounting computer systems, i.e. if for example new reports need to be created. The head of the department has the main responsibility for the implementation, though one of the accountants leads the work. The allocation of IAS among the accountants depends on the previous knowledge and special knowledge in some issues. For example, if an accountant works with cash flow for the group, it is natural that this person will work with the IAS concerning cash flow. There are also IAS in which no accountant has previous knowledge. These standards are assigned to accountants with time to deposit. By using these work procedures reorganisation is not necessary.

Regarding IAS 32 and IAS 39 SKF has started a project evaluating present use of accounting procedures for financial instruments. This project will be running for half a year. SKF has put more resources at the disposal for IAS 32 and IAS 39 than for the other standards. Further, an external auditor who is specialised in financial derivatives and who has been involved in previous implementation processes is used as a consultant. However, this issue concerns the treasury department; it is not an issue for the 'Group Accounting and Reporting' department.

5.4.2 Implementation plan

During the spring/summer 2002 SKF has started the implementation process of IAS, by performing an inventory of the standards not yet implemented in Sweden, in order to find out whether any of the standards will cause problems. Further, the department has identified the standards depending on when they are going to be implemented into Swedish GAAP, which is discussed in the next paragraph. Next, the 'Group Accounting and Reporting' department will identify the differences between IAS and SKF GAAP and analyses the effects the implementation will have. This analysis concerns whether the implementation will change the reporting procedures, the collection of information, the accounting computer system, or the instruction given to the subsidiaries. Further the department will identify whether the changes will have any material effects on the result or whether there will only be disclosure effects. Finally the department will update the manuals, the reports and the accounting computer system.

Since SKF follows Swedish GAAP, the IAS implemented in Sweden have been implemented by SKF consecutively, by updating the annual report and the instructions to the subsidiaries. Further comparisons with US GAAP have been made in order to find out if there are any problems with the reconciliation to US GAAP. The 'Group Accounting Reporting' department states that the reason for not implementing IAS earlier than the standards are implemented in Swedish GAAP is that there is no benefit in having different principles, i.e. Swedish GAAP and IAS.

Since US GAAP requires SKF to have two years comparative figures, the 'Group Accounting and Reporting' department believes there could be a benefit of implementing the IAS not yet implemented in Swedish GAAP 2003. Otherwise, problems could arise 2005 when the annual report from 2003 is

supposed to be presented in accordance with IAS. Instead of implementing the standards in 2003, SKF might decide to collect the information required to fulfil IAS, in addition to present accounting information. Thus, in 2005 SKF could adjust its financial statements in accordance with IAS. The company has not yet decided whether to implement the standards 2003 or only to collect the information necessary to fulfil the standards. However, SKF's main rule is that the company implements IAS when Swedish GAAP requires the enterprises to apply the standards.

The 'Group Accounting and Reporting' department believes there is enough time for the implementation of IAS, since the department does not believe that these changes are very large. According to the 'Group Accounting and Reporting' department these kinds of changes are conducted all the time. Even though there might be more changes in SKF GAAP when implementing all remaining IAS, than previous implementations of new accounting standards, the department believes the changes are feasible. The 'Group Accounting and Reporting' department also states that the company has reached far in the implementation process.

5.4.3 Consultants and external auditors

When it comes to implementing accounting standards, the 'Group Accounting and Reporting' department does not obtain assistance by consultants who are specialists in organisational change. However, the department has a close relationship with the external auditors. If the accountants in the department are insecure regarding an interpretation of a standard, the accountants address the external auditors to get their interpretation of the standard. Both parties are interested in making the same interpretation. Furthermore, every autumn SKF meets the external auditors to discuss all new changes in accounting standards and decide how to handle these changes.

5.4.4 The accounting computer system

The 'Group Accounting and Reporting' department always considers automatization, which means that the department tries to use different accounting programs instead of performing the tasks manually. If a report is to be made each month, adjustments are made in the accounting computer system. However, if a report is to be made on a yearly basis, it might not be necessary to make large adjustments in the accounting computer system.

5.4.5 Bringing the manuals up to date

The ‘Group Accounting and Reporting’ department publishes the manuals on the intranet, in which the manuals are always available for the subsidiaries. As soon as an instruction is ready for use it is published on the intranet. By having this system the local accountants will always have instructions that are up to date.

5.4.6 Assessing effects

The ‘Group Accounting and Reporting’ department states there is no general way in assessing the effects of a standard, rather the specific standard has to be understood. Sometimes there will be an effect on the result, and sometimes there are only disclosure requirements. The difficulties in collecting the information and secure the quality also depend on the particular standard.

5.4.7 The implementation of IAS in the subsidiaries

According to the ‘Group Accounting and Reporting’ department, it is a decision for the subsidiaries to decide whether to use IAS in the local accounts or not, when the use of IAS is allowed according to local GAAPs. However, the use of IAS could simplify the work for the local accountants, since they only have to perform one set of financial statements.

The local accountants will not be educated in IAS. Instead, the information will be provided in the manuals. However, in exceptional cases courses will be provided. For example, there will be a course in post retirement benefits since IAS 19 is rather comprehensive.

The ‘Group Accounting and Reporting’ department tries to make the manuals simple, with not too many details. The local accountants does not need to know the principles, it is enough to follow the instructions.

The ‘Group Accounting and Reporting’ department states that since learning new accounting instructions is included in the local accountants’ tasks, they will probably not have difficulties when learning IAS. The local accountants are employed in order to work in an international environment, and SKF presumes these accountants have a certain level of knowledge. Further there is a Chief Financial Officer in each subsidiary, who has the capability of handling new accounting instructions.

5.4.8 The human factor and resistance

When changes in accounting instructions are made, the local accountants might get more tasks to conduct, and it might be more difficult to obtain the required information. Therefore changes in accounting instructions are not always appreciated by local accountants. However, once the change is conducted, the new accounting procedure is included in the system. Thus, each change in accounting procedure is only made once. Also, since changes in the accounting instructions occur every year the local accountants are used to changes. Conversely, there is always a risk the accountants make incorrect interpretations and mistakes. This situation could theoretically occur when calculating for employee benefits in accordance with IAS 19. However, according to the 'Group Accounting and Reporting' department there is no risk the subsidiaries will unconsciously make miscalculations since the local accountants will not conduct these calculations by them selves; the local accountants will be assisted by actuaries.

6 Comparison between IAS and SKF GAAP

In this chapter, after an introduction, the comparisons between the IASB's accounting standards and the principles used by SKF are presented. After that SKF's accountants' comments to these comparisons are disclosed.

6.1 Introduction

This part of the study is conducted in order to find out what SKF needs to change in order to fulfil the IASB's accounting standards. The comparison is based on SKF's situation today. Hence, the differences between IAS and SKF GAAP will probably not be the same in the future. The comparison is conducted between IAS and the accounting principles applied by SKF, the so-called SKF GAAP. SKF follows Swedish GAAP but tries to adjust their accounting towards US GAAP when this is allowed, according to Swedish GAAP, in order to minimise the differences between the two GAAPs. According to SKF, the company follows US GAAP with certain specified exceptions: (i) revaluation of material capital assets is permitted; (ii) interest expense incurred in connection with the financing of newly constructed capital assets is not capitalized; (iii) costs associated with developing or acquiring computer software intended for internal-use are not capitalized or amortized; (iv) hedging of anticipated transactions not covered by firm commitments are reported as hedges; (v) periodic pension cost and liability and postretirement benefits are calculated by the SKF Group according to local law and accounting principles (SKF, 2001). The subsidiaries are required to report these areas in separate reports to the 'Group Accounting and Reporting' department in order to conduct the reconciliation note for US GAAP in the financial statements.

The comparisons include on one hand International Accounting Standards 2002 and exposure drafts issued by the IASB, and on the other hand SKF's External Report Manual 2002, SKF's Accounting Manual 2000, and SKF's Annual Report 2001. The exposure drafts issued by the IASB that are used are 'Improvements to International Accounting Standards' (IASB, 2002b), 'Amendment to IAS 19 Employee Benefits - The Asset Ceiling' (IASB, 2002c) and 'Improvements to IAS 39, Financial Instruments: Recognition and Measurement and IAS 32 Financial Instruments: Disclosure and Presentation' (IASB, 2002d). Since the company follows US GAAP to a large extent, the FASB's 'Original Pronouncements 2001/2002 Edition Accounting Standards' (FASB, 2001a) and the FASB's 'Accounting Standards Current Text' (FASB,

2001b) have been used. In the FASB's Original Pronouncements we have used Financial Accounting Standards (FAS), Accounting Research Bulletin (ARB), Accounting Principles Board's opinions (APB) and the FASB's Interpretations (FIN). Further, we have used a summary of proceedings of the FASB's Emerging Issues Task Force (FASB, 1999). We have also studied recent changes published on both the FASB's and the IASB's websites. Furthermore, since SKF explicitly refers to Miller's Comprehensive GAAP Guide (Williams, 2002) for use by the subsidiaries, that book has also been used. Therefore, when nothing is to be found regarding a special item in SKF's manuals or financial statements, the principle is that SKF follows US GAAP. Finally, we have used standards released by the Swedish Financial Accounting Standards Council; these standards are denominated RR1 etc, and standards released by the Swedish Institute of Authorised Public Accountants; these standards are denominated FAR NR 1 etc (FAR, 2002).

As can be read in section 6.37, 6.38 and 6.39 there are no differences between IAS and SKF GAAP when it comes to IAS 36, IAS 37 and IAS 38. These standards were implemented in SKF GAAP during 2002. The instructions regarding these standards were not provided by SKF for our comparison between IAS and SKF GAAP. However, the SKF's accountants state SKF fulfils IAS on these standards and SKF's external auditors have approved the standards. Thus, IAS 36, IAS 37, and IAS 38 are regarded as fulfilled in the comparison between IAS and SKF GAAP.

The comparisons follow the IAS in chronological sequence in order to make the comparison easier to follow. Each comparison has different sections depending on whether SKF follows US GAAP or not, and whether there are any exposure drafts regarding the issue that will affect SKF. In the first part 'Comparison between IAS and SKF GAAP', the differences between IAS and the accounting principles stated in SKF's External Report Manual and Accounting Manual are presented. In the second part differences between IAS and US GAAP are presented in areas where SKF's External Report Manual, Accounting Manual or Annual Report do not address or show the issue, but refer to the issue through Miller's Comprehensive GAAP Guide. Also, in this part issues are discussed when SKF has extra instructions for the subsidiaries in order to fulfil the disclosures for US GAAP. Thus, everything mentioned in the 'IAS – US GAAP' section are potential disclosure issues for the US GAAP note.

After each standard follows SKF's comments given by 'Group Accounting and Reporting' department on the discussed differences. These comments are based on SKF's situation today, which is discussed above.

6.2 IAS 1 – Presentation of Financial Statements

6.2.1 Comparison between IAS and SKF GAAP

IAS 1.75 requires the financial cost to be disclosed in the income statement as a separate line item. SKF, on the other hand, nets the financial cost and the financial income and presents the cost and financial income in note 4.

6.2.2 Comparison between IAS and US GAAP

IAS 1.13 states that in extremely rare circumstances a departure from a requirement is necessary in order to achieve a fair presentation. The same exception is not to be found under US GAAP.

6.2.3 Comparison between the IASB's exposure draft 'Improvements to International Accounting Standards' and SKF GAAP

In the exposure draft the following standard is added as IAS 1.110: *"An entity shall disclose in the notes information regarding key assumptions about the future, and other sources of measurement uncertainty, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In respect of those assets and liabilities, the notes shall include details of: (a) their nature; and (b) their carrying amount as at the balance sheet date"*. IAS 1.113 gives some examples of information regarding key assumptions to be disclosed. These are: future interest rates, future changes in salaries, future changes in prices affecting other costs, and useful lives. SKF does not fulfil these disclosure requirements.

SKF Comments: The 'Group Accounting and Reporting' department believes that the differences discussed above will not lead to any major changes in SKF GAAP. Changes in disclosures for 2003 will be made since RR22 will be effective January 1st, 2003. The information is available and SKF's result will not be affected, according to the department. Further, the changes will be simple to perform.

6.3 IAS 2 – Inventories

6.3.1 Comparison between IAS and SKF GAAP

According to IAS 2.34(c) the carrying amount of inventories carried at net realisable value should be disclosed. This is not done in SKF's Annual Report (SKF, 2001).

SKF Comments: The 'Group Accounting and Reporting' department states that the change in SKF GAAP, caused by IAS 2, will only be a disclosure change. The department does not have the information required by IAS 2 today, which is due to the fact that SKF follows Swedish GAAP (RR2) that only substantial follows IAS 2. However, the department states that there should not be any complications for the local accountants in the subsidiaries to provide this information to the 'Group Accounting and Reporting' department. The reason is that the information at present is located in the subsidiaries' accounts for inventories, and is used when accounting for obsolescence reserves and for net realizable value reserves.

6.4 IAS 3 (Superseded)

Superseded by IAS 27 and IAS 28.

6.5 IAS 4 (Superseded)

Superseded by IAS 16, IAS 22 and IAS 38.

6.6 IAS 5 (Superseded)

Superseded by IAS 1.

6.7 IAS 6 (Superseded)

Superseded by IAS 15.

6.8 IAS 7 – Cash Flow Statements

6.8.1 Comparison between IAS and US GAAP

According to IAS 7.8 bank borrowings are normally considered as a borrowing activity. But in some countries when bank overdrafts form an integral part of an enterprise's cash management, bank overdrafts that are payable on demand shall be included in the 'cash and cash equivalents'. Thus, overdrafts would not be identified as a change in cash flows since cash flow excludes movements

between items that consist of cash or cash equivalents. FAS 95 does not have this requirement where bank overdrafts are included as an inflow or outflow of the liability. Therefore under US GAAP, bank overdrafts are normally disclosed as a liability on the balance sheet, and are only offset against cash if the company has another cash account (with a positive balance) with the same bank. In that case, offsetting is required.

IAS 7.48 requires a company to disclose, together with a management commentary, the amount of significant cash and cash equivalent balances held by the company that is not available for the group. IAS 7.49 gives an example when a subsidiary is located in a country where exchange control or other legal restrictions exist, which makes the balance not available by parents or other subsidiaries. In US GAAP, if cash is restricted, for example legally, if material, it is separated from the normal cash on the balance sheet, and is classified as either a current asset or a long-term asset. Thus, such cash would probably be treated as an investment, not as cash equivalent under US GAAP.

SKF Comments: SKF's 'Group Accounting and Reporting' department states that regarding bank overdrafts, all cash is handled at the treasury department, where the cash account is positive. Further, the department states that SKF's cash not available for the group is a non-material item. Thus, there will be no changes in SKF GAAP regarding cash flow.

6.9 IAS 8 – Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Principles

SKF follows this standard.

6.10 IAS 9 (Superseded)

Superseded by IAS 38.

6.11 IAS 10 – Events After the Balance Sheet Date

SKF follows this standard.

6.12 IAS 11 – Construction Contracts

6.12.1 Comparison between IAS and SKF GAAP

IAS 11.22 requires that the stage of completion method (percentage of completion method) should be used when recognising contract costs and

revenue when the outcome of a construction contract can be estimated reliably. This is the same method as the one applied by SKF. In contrast, when the outcome of a construction contract cannot be estimated reliably, IAS 11.32 states that ‘the zero-profit method’ shall be used, where the revenue is recognised only to the extent of contract costs incurred that are expected to be recovered. SKF in contrast, uses the ‘Completed-Contract Method’. This method recognises income only when the contract is completed or substantially completed (SKF, 2000). SKF’s approach in this matter is in line with US GAAP and ARB 45.15.

IAS 11.9 describes the criteria for when the contracts or segments of contracts are to be combined. US GAAP does not require this procedure and the area is not considered by SKF.

SKF Comments: According to the ‘Group Accounting and Reporting’ department SKF has very few construction contracts. The department states that this implies there will be no effect in SKF’s result regarding the accounting method of a construction contract that cannot be estimated reliably. However, the department claims that SKF will have to update the manuals and describe the accounting principles regarding construction contracts better. Finally, the department states that there will be no changes in the reporting procedures since there is no need to add extra lines in the manuals, with the purpose of collecting new information. Neither will there be any disclosure changes since this item is not material.

6.13 IAS 12 – Income Taxes

6.13.1 Comparison between IAS and SKF GAAP

IAS 12.46 requires recognition of the effects of a change in tax laws or rates when the change is “*substantively enacted by the balance sheet date*” when calculating current tax liabilities and assets. Also IAS 12.47 requires calculation of deferred tax assets and liabilities on tax rates that are “*enacted or subsequently enacted by the balance sheet date*”. According to IAS 12.48 recognition may precede actual enactment by a period of several months where the enactment of a new tax law is viewed as a discrete event of the period of enactment. In the Accounting Manual, there is a statement that declares: “*the effects of future expected changes in tax laws or rates are not anticipated*”

(SKF, 2000, p. 277), which conflicts with the IAS requirement (SKF, 2002, p. 80).

All deferred tax liabilities and assets are to be classified as noncurrent in a classified statement of financial position according to IAS 12.70. SKF describes in the Accounting Manual, that deferred tax liabilities and assets shall be classified as current or noncurrent based on the related classification of asset or liability (SKF, 2000). This conflicts with IAS.

6.13.2 Comparison between IAS and US GAAP

When a company buys an asset, there might be a non-taxable government grant or an investment tax credit. In FAS 109.116 a deferred tax asset is recognised for those deductible temporary differences, while IAS 12.33 does not recognise a deferred tax asset in this situation.

FAS 109.9(f) prohibits a company from recognising deferred taxes for temporary differences related to foreign non-monetary assets when the reporting currency is the functional currency. In contrast, IAS 12.41 requires this.

As described above, IAS requires recognition of the effects of a change in tax laws substantively enacted by the balance sheet date when calculating current tax liabilities and assets. The recognition may precede actual enactment by a period of several months where the enactment of a new tax law is viewed as a discrete event of the period of enactment. FAS 109.27 requires recognition upon actual enactment, which, under US GAAP, is the date the president signs the tax law.

The next issue is how to account for the income tax consequences of dividends from a subsidiary to a parent enterprise. In some countries, previously paid income taxes may be refundable if retained earnings are paid out as a dividend, while in other countries additional income taxes are payable if retained earnings are paid out as a dividend. When it comes to tax consequence of those cases, IAS 12.52A requires that an enterprise should measure current and deferred tax assets and liabilities using the tax rate applicable to undistributed profits. IAS 12.52B also requires that an enterprise should recognise the income tax consequences of dividends when the dividends are recognised as a liability. In most cases, those consequences are included in net profit or loss for

the period. IAS 12.82(a) finally requires that a company should disclose information about the potential income tax consequences of dividends. US GAAP has a different approach where EITF Issue No. 95-10, 'Accounting for Tax Credits Related to Dividend Payments in Accordance with the FASB Statement No. 109', states that tax benefits obtained upon payment of dividends should be recognized as a reduction of income tax expense in the period that the tax credits are included in the enterprise's tax return. The timing for recognition of additional taxes that become payable if dividends are paid are not addressed by EITF Issue No. 95-10. However, US tax law excludes some of the dividends received from taxation, so that some of the profits are not being taxed for a second time. Between 42 and 80 percent of dividends received are not taxed, depending on the ownership, and depending on whether the subsidiary is foreign or not (IRS, Website). The result is that the dividends received, which are not taxable, create a permanent tax difference, creating neither deferred tax assets nor tax liabilities. The part that is taxable is taxable when declared, and creates no timing differences with financial statements. Therefore, under US GAAP no deferred items can arise if there are no timing differences, while under IAS a deferred tax effect is recognised.

Concerning items credited or charged directly to shareholders' equity during current year, both FAS 109 and IAS 12 require that any related tax effects shall also be allocated to equity. IAS 12.61 requires allocation to equity of current year's deferred taxes related to items credited or charged to equity in prior years. FAS 109.39 on the other hand prohibits this.

According to IAS 12.68 there shall be reduction of goodwill upon subsequent recognition of acquired tax benefits that were not recognised at the acquisition date in accounting for a business combination. After goodwill is reduced to zero, subsequent recognition of any additional acquired tax benefits increase earnings. FAS 109.30 requires reduction to zero of goodwill and any acquired intangible assets before acquired tax benefits increase earnings.

SKF Comments: The only major difference that needs to be adjusted is the reclassification, according to the 'Group Accounting and Reporting' department. SKF does not follow the IASB's procedures regarding this issue, and therefore SKF GAAP needs to be modified. Since the subsidiaries already report the needed data, the department only have to rotate the figures.

About the other differences, the ‘Group Accounting and Reporting’ department states that no changes need to be made in the reporting procedures. Therefore, if changes are required to be made, the information is available. According to the department the difference regarding changed tax laws is addressed in each specific case. Regarding taxes on dividends, the department states that SKF has small amounts of these items, which makes this issue not material. Concerning items credited or charged directly to shareholders’ equity during current year, SKF takes most part through the income statement and allows very little part to be taken directly to shareholders’ equity. Finally, regarding the treatment of the reduction of goodwill, the ‘Group Accounting and Reporting’ department states that recently SKF has only bought small companies, which makes this item to be nonmaterial.

6.14 IAS 13 (Superseded)

Superseded by IAS 1.

6.15 IAS 14 – Segment Reporting

6.15.1 Comparison between IAS and SKF GAAP

IAS 14.26 separates primary and secondary segments. This is not made by SKF. Further, IAS 14.44 requires disclosure segment liabilities, which is not made in SKF’s financial statements.

Much of the disclosure information required by IAS 14 is found in the last page in SKF’s Annual Report. This information is not included within those pages signed by the external auditor, and needs to be moved.

SKF Comments: The ‘Group Accounting and Reporting’ department will analyse SKF’s segmental reporting in order to find out whether the company can use the segmental reporting as it is today, or if extra information is necessary in order to fulfil IAS 14. SKF’s ‘Group Accounting and Reporting’ department believes the company basically presents the segmental reports in accordance with IAS when it comes to business segments. However, the ‘Group Accounting and Reporting’ department believes that some information probably needs to be added, and the definitions need to be analysed. Further, the department believes that there might be

changes in how the reports from subsidiaries are structured, since it is not clear if SKF has all the information today. The ‘Group Accounting and Reporting’ department believes that there will probably not be any major changes in how the data is collected in the subsidiaries.

6.16 IAS 15 – Information Reflecting the Effects of Changing Prices

IAS 15 is a non-mandatory standard.

6.16.1 Comparison between the IASB’s exposure draft ‘Improvements to International Accounting Standards’ and SKF GAAP

According to the exposure draft the Board proposes to withdraw IAS 15 as of 1 January 2003.

6.17 IAS 16 – Property Plant and Equipment

6.17.1 Comparison between IAS and SKF GAAP

In IAS 16.15(e) guidance is given on the principle that the cost of an item of property, plant and equipment also includes the costs of dismantling and removing the asset and restoring the site on which that asset is located. This subject is not addressed by SKF.

Revaluation of assets is allowed in IAS 16.29. SKF allows revaluation but there are some differences from IAS practice. According to the Accounting Manual assets may be revalued individually or per class (SKF, 2000), while IAS 16.34 demands that an entire class of property should be revalued. This is done in order to avoid selective revaluation with the effect of mixtures of items with valuations from different dates (IAS 16.36).

IAS 16.61 requires disclosure of commitments to acquired assets. In IAS 16.64 there are certain requirements associated with the revalued assets not disclosed by SKF.

6.17.2 Comparison between IAS and US GAAP

Revaluation of assets is allowed according to IAS 16.29, while FAS 144 does not provide for revaluation upward, but does provide for revaluation downward.

IAS 16.49 and IAS 16.52 require that the useful life and the depreciation method applied to property, plant and equipment are reviewed periodically and adjusted in significantly changed circumstances. US GAAP does not require these procedures, but permits them, so long as any changes are properly accounted for under APB Opinion 20. SKF GAAP does not apply the procedures that are required by IAS.

6.17.3 Comparison between the IASB's exposure draft 'Improvements to International Accounting Standards' and SKF GAAP

As described above, IAS requires that the useful life and the depreciation method applied to property, plant and equipment be reviewed periodically and adjusted in significantly changed circumstances. In IAS 16.49 in the exposure draft, 'reviewed periodically' is defined as at least at each financial year-end. US GAAP does not require these procedures and SKF GAAP does not apply these procedures.

SKF Comments: The 'Group Accounting and Reporting' department states that the information needed for revaluation of assets is available. So far SKF has revalued companies and assets individually. IAS on the other hand states that if revaluation is made, it has to be done each year and in all companies. Due to the practical problems when assets shall be revalued each year and in all companies, SKF will probably not make revaluation in the future. The 'Group Accounting and Reporting' department believes that adjustments retroactive will not be required. Future figures will be in line with US GAAP and IAS, but historical figures will not be correct. Also, since SKF has not made any material revaluations the last years, this strengthens the principle that SKF will not continue with this procedure. Thus, the 'Group Accounting and Reporting' department states that there will be no effect in the result, when adopting these accounting procedures.

According to the 'Group Accounting and Reporting' department, IAS 16.49 and 16.52 are 'impossible rules'. Therefore SKF will not review the useful life and the depreciation method applied to property, plant and equipment periodically. SKF approaches this problem from another direction; when there are impairments in the

assets, this might be an indication that something is incorrect and the depreciation method and useful life of the asset are analysed.

According to the ‘Group Accounting and Reporting’ department it is not clear which information SKF needs to collect from its subsidiaries in order to fulfil IAS 16.61 and 16.64.

6.18 IAS 17 – Leases

SKF follows this standard.

6.19 IAS 18 – Revenue

6.19.1 Comparison between IAS and SKF GAAP

SKF uses the same method as IAS recommends when recognising revenue associated with a transaction that involves rendering of services and the outcome can be estimated reliably. However, when the outcome of the transaction cannot be estimated reliably, the methods used by IAS and SKF GAAP differ. IAS 18.26 states that in this situation “*revenue should be recognised only to the extent of expenses recognised that are recoverable*”. SKF in contrast uses an alternative method, the ‘Completed-Contract Method’, which recognises income only when the contract is completed or substantially completed (SKF, 2000).

SKF Comments: The ‘Completed Contract Method’ is an alternative method, which the subsidiaries use very seldom, according to the ‘Group Accounting and Reporting’ department. The department does not know how many of the subsidiaries are using this method. Hence, the department states that it is uncertain whether the changes in SKF GAAP, in order to fulfil IAS 18, would lead to any change in the company’s result. However, the department states that the effect should not be major enough to cause any material effects, since the method is used in exceptional cases.

6.20 IAS 19 – Employee Benefits

6.20.1 Comparison between IAS and SKF GAAP

IAS 19.52 requires that a company should account “...*for any constructive obligation that arises from the enterprise’s informal practise*.” This area is not discussed in SKF’s Accounting Manuals.

IAS 19.64 requires the enterprise to use the Projected Unit Credit Method to determine the present value of its defined benefit obligations, the related current service cost and past service cost. This method is “...an actuarial valuation method that sees each period of service as giving rise to an additional unit of benefit entitlement and measures each unit separately to build up the final obligation”. In contrast SKF does not describe any special way of determining the present value of the defined benefit obligations with its related current service cost and past service cost (SKF, 2000). Instead, the manual states in a general way that there are different ways of how to do the determination. In SKF’s External Report Manual the description of the items to include in ‘Pension and similar items’ in the balance sheet is general. “State pensions and similar items which are defined as an employee’s right to future benefits subsequent to retirement age. The benefit is earned during the employee’s employment time, while payments are made during the retirement lifetime” (SKF, 2002, p.30).

IAS 19.78 recommends that the interest rate to be used to discount post-employment benefit obligations should be determined by reference to market yields at the balance sheet date on high quality corporate bonds (IASB, 2002). Further the standard states that in countries where there is no market in such bonds, the market yields on government bonds should be used. The Accounting Manual (SKF, 2000), on the other hand, recommends the subsidiaries to use the interest rates set by accounting bodies or similar announcements to be used for the calculation of pension benefits. However, the Accounting Manual does not specify any accounting body. SKF’s Accounting Manual states that if such guidelines do not exist, a long-term interest rate, such as a five to thirty years bond rate, should be used.

IAS 19.83 proclaims that post-employment benefit obligation should include an estimation of future salary increases, etc. It should also be measured on a basis that reflects the benefits set out in terms of the plan. That is, if the plan requires the enterprise to change benefits in future periods, the measurement of the obligation should reflect those changes. This is inconsistent with Swedish practice, which states that future salary, and pensions increases should not be included in estimation of the net present value (FAR Nr 4). According to the Accounting Manual the company accounts for agreements, which are in substance similar to pension plans, in accordance with SKF’s principles applied for pensions (SKF, 2000).

IAS 19.104 requires recognition, measurement and disclosure of reimbursements. SKF's Accounting Manual or External Reporting Manual does not discuss this area.

IAS has several disclosure requirements that can be found in SKF's reconciliation for US GAAP. However there are some additional disclosure requirements in IAS 19.120 (b) that are not fulfilled by SKF. These are requirements for the company to disclose a general description of the type of plan, for example flat salary pension plans, final pension plan and post-employment medical plans.

6.20.2 Comparison between IAS and US GAAP

IAS 19.30 requires a company to define a multi-employer plan as a defined benefit plan or a defined contribution plan under the terms of the plan. US GAAP only permits a multi-employer plan to be accounted for as a defined contribution plan (FAS 87. 68).

According to IAS 19.56 the measurement date is to be the balance sheet date, while US GAAP permits use of measurements date three months old (FAS 87.52; FAS 106.72).

Both IAS 19.78 and FAS 87 require that the rate to be used when discounting pension obligations should be determined by reference to market yields at the balance sheet date on high quality corporate bonds. However, IAS 19 adds that when there is no market in these bonds, the market yields on government bonds should be used.

Under US GAAP, pensions based on 'flat-benefit plan' are not based on future compensation levels (FAS 87.40). IAS 19.83, on the other hand, requires that post-employment benefit obligations should be based on future compensation levels.

IAS 19.88 requires assumptions about changes in future costs of medical services etc, when determining post employment benefit obligation. FAS 87.47 by contrast prohibits inclusion of increases in the social security wage base as assumption.

FAS 106.101 distinguishes special or one-time termination benefits when employees accept the offer and the amount can be reasonably estimated. There should be recognition of a liability and a loss in this situation. IAS does not distinguish this item, but treats it as other termination benefits under IAS 19.133-19.134. Thus, a company following US GAAP might recognise a termination benefit not allowed under IAS.

6.20.3 Comparison between the IASB's exposure draft 'Amendment to IAS 19 Employee Benefits - The Asset Ceiling' and SKF GAAP

The asset ceiling in IAS 19 can be described as it allows deferred recognition of actuarial gains and losses. It also imposes an upper limit on the amount that can be recognised as an asset. The issue has arisen on the interaction of deferred recognition and the asset ceiling, where the issue affects only those entities that have, at the beginning or end of the accounting period, a surplus in a defined benefit plan that, based on the current terms of the plan, the entity cannot fully recover through refunds or reductions in future contributions. In this situation the phrasing of the asset ceiling has the following consequence: deferring the recognition of an actuarial loss/gain leads to a gain/loss being recognised in the income statement. This exposure draft proposes a limited amendment to IAS 19 that would prevent gains/losses from being recognised solely as a result of past service cost or actuarial losses/gains arising in the period. However, no change is discussed to the general approach of allowing deferral of actuarial gains and losses.

SKF's comments: The 'Group Accounting and Reporting' department claims that the changes in accounting principles caused by IAS 19 are major changes in SKF GAAP. According to the department these changes would imply a totally new way of making the calculations for post retirement benefits. The department believes IAS 19 is one of the most difficult standards since the standard has a very complex set of rules, which makes the standard very difficult to analyse. The department claims the result will be affected, although it is impossible to assess how large the effect on the result will be.

One of the accountants in the 'Group Accounting and Reporting' department has been working fulltime during several months with this standard. According to the department it is very seldom that SKF needs to put that much work in one single standard. The reason for

having one accountant working full time is that a lot of information and instructions need to be sent to the subsidiaries about exactly how the changes are to be conducted.

Since the standard is hard to understand redoing the post employment benefit calculations might be difficult, according to the 'Group Accounting and Reporting' department. The accountants in the subsidiaries have to identify the different types of post employment benefits. It can also be difficult for the accountants in the subsidiaries to understand whether the plans are defined contribution plans or defined benefit plans. When the defined contribution plans and the defined benefit plans are identified, an actuary will conduct the actual calculation. These experts will assist the local accountants when conducting the calculations for the post employment benefit obligation since the local accountants cannot make these calculations by themselves. This will lead to higher costs locally. Further, there will be a lot of work for the 'Group Accounting and Reporting' department who are supposed to show the consolidated opening balance for the first time.

The department claims that the items will not be adjusted for retroactively. Instead there will be a one-time adjustment in the year when the standard is adopted where previous years are recalculated, and after that calculate forward. According to the 'Group Accounting and Reporting' department there is a lot of work that needs to be made, both in calculating new opening balances and also calculate forward.

According to the 'Group Accounting and Reporting' department IAS 19 is based on FAS 87. The large subsidiaries have previously used FAS 87 for SKF's reconciliation note for US GAAP. However, after IAS 19 is implemented more subsidiaries will make this calculation and give up local principles.

6.21 IAS 20 – Accounting for Government Grants and Disclosure of Government Assistance

SKF follows this standard.

6.22 IAS 21 – The Effects of Changes in Foreign Exchange Rates

The differences between IAS 21 and SKF GAAP are due to the differences between IAS 29 and SKF GAAP, which will be discussed in section 6.30.

6.23 IAS 22 – Business Combinations

6.23.1 Comparison between IAS and US GAAP

IAS 22.13 requires the pooling method to be used if no acquirer can be identified, while FAS 141.13 states that all business combinations must be accounted for as purchases.

In-process research and development, which is included in a business purchase, is to be capitalized according to IAS 22.38. There is a reference to IAS 38, which has certain requirements for capitalisation (IAS 38.27-32; IAS 38.56(b)). Under US GAAP purchased research and development must be expensed (FAS 141.39; FAS 141.B170).

FAS 142.18, states that goodwill shall not be amortized (acquired after June 30, 2001 according to FAS 142.50). Instead goodwill shall be tested for impairment at least on an annual basis (FAS 142.26). Since IAS 22.44 requires goodwill to be amortized, US GAAP's requirement of no amortization of goodwill will also lead to accounting differences in other paragraphs, for example IAS 22.45, IAS 22.54 and IAS 22.56.

IAS 22.59 requires that the excess in fair value over cost of acquisition to be recognised as negative goodwill. US GAAP FAS 141.44-45 claims that an excess over cost should be allocated to reduce the values assigned to defined assets, and the rest should be negative goodwill.

SKF's comments: SKF's 'Group Accounting and Reporting' department states that SKF will never have a pooling situation, and that SKF will continue to amortize goodwill in accordance with IAS.

When it comes to identifying and testing for potential impairment of goodwill, SKF's 'Group Accounting and Reporting' department will try to harmonize accounting instructions for the subsidiaries in order to fulfil both IAS's and US GAAP's requirements. Companies are required to conduct impairment tests once a year according to US

GAAP, while IAS states these tests do not have to be conducted annually but as fast as the companies have indications of impairment. Therefore, SKF's 'Group Accounting and Reporting' department is writing an instruction where the test for impairment will fulfil both requirements. However, this instruction will not be sent to all local accountants since SKF does not have many business units with a goodwill value. There will also be adjustments for the US GAAP note in the financial statements, where the amortizations that are made in accordance to IAS are recalculated and added as impairments. SKF had a stop date by January 2002, when the amortizations according to US GAAP were not made anymore.

SKF does not know whether there will be an effect on the result due to the new rules. Since SKF has revalued goodwill in the past, impairment of goodwill is not a new principle for the company. However, SKF needs to change the accounting procedures and make the instructions for the subsidiaries clearer. This will also be made for negative goodwill. According to the 'Group Accounting and Reporting' department SKF has negative goodwill under control. This is because the department knows which companies have negative goodwill and how it is calculated. SKF has to make recalculation of these items for the reconciliation for US GAAP. Eligible

6.24 IAS 23 – Borrowing Costs

SKF follows this standard.

6.25 IAS 24 – Related Party Disclosures

SKF's comments: The 'Group Accounting and Reporting' department sees no difficulties with IAS 24. However, the department and the external auditors will examine SKF's related parties, in order to confirm that the company has no related parties, with the present structure of the ownership, that are material enough to be disclosed. Thus, the department claims that this standard will probably not cause any changes in SKF GAAP.

6.26 IAS 25 (Superseded)

Superseded by IAS 39 and IAS 40.

6.27 IAS 26 – Accounting and Reporting by Retirement Benefit Plans

This standard is not applicable to SKF.

6.28 IAS 27 – Consolidated Financial Statements and Accounting for Investments in Subsidiaries

SKF follows this standard.

6.29 IAS 28 – Accounting for Investments in Associates

SKF follows this standard.

6.30 IAS 29 – Financial Reporting in Hyperinflationary Economies

6.30.1 Comparison between IAS and SKF GAAP

Neither IAS nor SKF establish an absolute rate at which hyperinflation is considered to arise. The Accounting Manual states that an economy considered to be highly inflationary has a cumulative inflation of approximately 100 percent or more over a three-year period. IAS gives a far more deep description of whether or not an economy is to be considered highly inflationary.

IAS 29.8 states that *“the financial statements of an enterprise that reports in the currency of a hyperinflationary economy, whether they are based on a historical cost approach or a current cost approach, should be stated in terms of the measuring unit current at the balance sheet date...”*. SKF GAAP requires that the financial statements should be restated using the monetary-non monetary method. *“Under this method, monetary assets and liabilities are translated at the current rate while non-monetary assets and liabilities are translated at applicable historical rates as follows: a) foreign currency monetary items should be converted using the closing rate, b) non-monetary items which are carried in terms of historical cost denominated in a foreign currency should be converted using the exchange rate at the date of the transaction, c) non-monetary items which are carried at fair value denominated in a foreign currency should be converted using the exchange rates that existed when the values were determined”* (SKF, 2000, p. 233).

6.30.2 Comparison between IAS and US GAAP

IAS 29 does not establish an absolute rate at which hyperinflation is considered to arise. Nor does the FASB. However, the two standards take slightly different

approaches when making judgment of whether hyperinflation exists or not. IAS 29.3 states: *“Hyperinflation is indicated by characteristics of the economic environment of a country which include, but are not limited to, the following: (a) the general population prefers to keep its wealth in non-monetary assets or in a relatively stable foreign currency. Amounts of local currency held are immediately invested to maintain purchasing power; (b) the general population regard monetary amounts not in terms of the local currency but in terms of a relatively stable foreign currency. Prices may be quoted in that currency; (c) sales and purchases on credit take place at prices that compensate for the expected loss of purchasing power during the credit period, even if the period is short; (d) interest rates, wages and prices are linked to a price index; and the cumulative inflation rate over three years is approaching, or exceeds, 100%.”* FAS 52.11 states that a highly inflationary economy exists when the cumulative inflation rate is approximately 100 percent or more over a 3-year period. Further, FAS 52.104 states that the point when hyperinflation exists is a subjective one. *“It depends on a number of factors, including the current and cumulative rates of inflation and the capital intensiveness of the operation. In principle, however, a more stable measuring unit is always preferable to a less stable one”* (FAS 52.104). As we can see, both standards are rather subjective when making judgements as to whether a highly inflationary economy exists or not, although IAS gives specific indications of characteristics of an economic environment that might be a highly inflationary environment. The major difference between the two standards is the way they use the cumulative inflation rate. IAS states that hyperinflation is indicated by the characteristic that cumulative inflation rate over three years is approaching, or exceeds 100 percent. FAS, on the other hand, believes that if cumulative inflation exceeds 100 percent the economy should be considered highly inflationary. On the other side, if cumulative inflation is less than 100 percent historical inflation rate trends and other pertinent economic factors should be considered when determining whether the economy is highly inflationary or not.

IAS 29 requires adjustment of the subsidiaries financial statements for the general effects of inflation, by applying a general price index, with the gain or loss on net monetary position in net income. IAS 29.8 states that *“the financial statements of an enterprise that reports in the currency of a hyperinflationary economy whether they are based on a historical cost approach or a current cost approach should be stated in terms of the measuring unit current at the balance sheet date”*. FAS 52.11 states that the financial statements of a foreign

entity in a highly inflationary economy shall be remeasured as if the functional currency were the reporting currency. This gives that monetary items are remeasured at the current rate; other assets are remeasured at historical rates. Equity accounts are remeasured at the historical rate. Income statement accounts are remeasured at the historical rate, which means average rates for some accounts, such as sales and some expenses, and actual historical rates for depreciation and amortization expenses.

SKF's comments: The 'Group Accounting and Reporting' department has not evaluated IAS 29 yet, but claims the standard could be a problem. Also, according to the department IAS 29 does not seem to be ready yet, and therefore the department does not know how the final standard will be treated. This circumstance makes it very hard for the 'Group Accounting and Reporting' department in practice, since the final standard could lead to a lot of changes. Thus, SKF does not know the consequences of adjusting SKF GAAP in accordance with IAS 29.

6.31 IAS 30 – Disclosures in the Financial Statements of Banks and Similar Financial Institutions

This standard is not applicable to SKF.

6.32 IAS 31 – Financial Reporting of Interests in Joint Ventures

6.32.1 Comparison between IAS and US GAAP

The requirement of when to account for a joint venture differs between IAS and US GAAP. IAS 31.2 requires that the arrangement is a *contractual* arrangement. According to IAS 31.2, a joint venture is a “*contractual arrangement whereby two or more parties undertake an economic activity which is subject to joint control*”. APB Opinion 18.3 does not have this requirement.

A venturer is a “*party to a joint venture and has joint control over that joint venture*” (IAS 31.2), while an investor is the party without control over a joint venture. Besides guidance for the financial statements of the venturer, IAS also provides directions for the financial statement procedures of the investor (IAS 39.42). APB Opinion 18 does not distinguish between the two parties. Further, IAS 31.39 provides guidance of how to account for transactions between a venturer and a joint venture, which is not mentioned by US GAAP.

IAS 31.10 requires the venturer to account for its share of jointly controlled operations; assets that it controls, liabilities that it incurs, expenses that it incurs, and its share of the income that it earns from sales of goods or services by the joint venture. These areas are not covered in APB Opinion 18, but AICPA Accounting Interpretation (AIN-APB) Opinion 18 #2 *allows* similar treatments as IAS.

IAS 31.16 requires the venturer to account for its share of jointly controlled assets, jointly incurred liabilities, and expenses and income incurred by the joint venture. The paragraph also requires the venturer to account for liabilities and expenses that the venturer has incurred in respect of its interest in the joint venture. These areas are not covered in APB Opinion 18.

SKF's comments: The 'Group Accounting and Reporting' department states that SKF has no interests in joint ventures, with the present structure of the ownership, that is material enough to be disclosed. Hence, the department claims the effects in the company's result of adjusting SKF GAAP for IAS 31 will not be material. Further, according to the department there will be no difficulties in the interpretation of IAS.

6.33 IAS 32 – Financial Instruments: Disclosure and Presentation

6.33.1 Comparison between IAS and SKF GAAP

We found differences between IAS 32 and SKF GAAP. The 'Group Accounting and Reporting' department gave only general comments on IAS 32; the department did not comment the differences we found between IAS 32 and SKF GAAP. Therefore, the comparison between IAS 32 and SKF GAAP is not disclosed.

SKF's comments: The same comments as for IAS 39.

6.34 IAS 33 – Earnings per Share

SKF follows this standard.

6.35 IAS 34 – Interim Financial Reporting

SKF follows this standard.

6.36 IAS 35 – Discontinuing Operations

SKF follows this standard.

6.37 IAS 36 – Impairment of Assets

SKF comments: This standard is implemented during the year and will be effective in the annual reports of 2002.

6.38 IAS 37 – Provisions, Contingent Liabilities and Contingent Assets

SKF comments: This standard is implemented during the year and will be effective in the annual reports of 2002.

6.39 IAS 38 – Intangible Assets

SKF comments: This standard is implemented during the year and will be effective in the annual reports of 2002.

6.40 IAS 39 – Financial Instruments: Recognition and Measurement

6.40.1 Comparison between IAS and SKF GAAP

We found differences between IAS 39 and SKF GAAP. The ‘Group Accounting and Reporting’ department gave only general comments on IAS 39; the department did not comment the differences we found between IAS 39 and SKF GAAP. Therefore, the comparison between IAS 39 and SKF GAAP is not disclosed.

SKF’s comments: The ‘Group Accounting and Reporting’ department claims that the problem with IAS 32 and IAS 39 is due to the exposure draft ‘Improvements to IAS 39, Financial Instruments: Recognition and Measurement and IAS 32 Financial Instruments: Disclosure and Presentation’. The problem is that present IAS 32 and IAS 39 are not the ones that will be used from 2005. Therefore, the department states that it is very difficult to conduct an analysis of these standards. On the other hand, IAS 32 becomes effective in Sweden 2003 under RR 27. SKF has started a project evaluating the accounting procedures for financial instruments used today and effects when applying IAS 32 and IAS 39. This project will be running for half a year.

A problem is that US GAAP requires two comparable years in the annual report, while IAS only requires one. Companies 'only' following IAS have an additional year in waiting for the final version of IAS 39 since these companies will only have 2004 as a comparable year when IAS are to be implemented in 2005. On the other hand companies following both IAS and US GAAP, like SKF, will have to start using IAS from 2003.

The department states that it is possible to analyse the exposure draft, but on the other hand, it is not certain if this will be adopted. Under accounting for hedges of a firm commitment IAS 39 uses cash flow hedge while US GAAP uses fair value hedge. The department believes that IAS 32 and IAS 39 will probably be changed towards fair value under US GAAP. In this case, the department believes the valuation is not a problem since SKF already has the information required.

According to the 'Group Accounting and Reporting' department US GAAP is normally considered to be much more detailed than IAS. However, when it comes to IAS 39, the department states that accountants regard IAS as much more complex than FAS 133.

The department claims that because IAS 39 is very complex it will be difficult for SKF to explain how the result is affected if the current version of IAS 39 is applied.

The 'Group Accounting and Reporting' department believes IAS 39 is one of the most difficult IAS to analyse due to the standard's complexity. The department further believes that this standard will demand great effort, both at the department and at the subsidiaries. According to the department, it is not possible to determine how much help the subsidiaries need. The first step should be to assess which types of contracts exist in the subsidiaries. The department claims it is impossible to assess how SKF's result will be affected in the end, but claims that the result probably will be affected.

6.41 IAS 40 – Investment Property

The standard discusses when assets shall be recognised as investment properties.

SKF's comments: SKF does not hold investment property.

6.42 IAS 41 – Agriculture

This standard is not applicable to SKF.

7 Analysis

In this chapter we will make an analysis based on the comments given by SKF regarding differences between IAS and SKF GAAP. Furthermore, we will make an analysis of the implementation process of accounting standards at SKF.

7.1 Comparison between IAS and SKF GAAP

7.1.1 Assessing the IAS which will change SKF GAAP

Of the forty-one International Accounting Standards, seven have been superseded. The superseded standards are IAS 3-6, IAS 9, IAS 13 and IAS 25. Therefore there are thirty-four standards that SKF must consider for potential implementation. In chapter 6 ‘Comparison between IAS and SKF GAAP’ we assessed that of these thirty-four standards three are not applicable to SKF and one standard is a non-mandatory standard. These standards are listed in Table 1.

Table 1: Not applicable and non-mandatory standards

IAS 15 – Information Reflecting the Effects of Changing Prices (non-mandatory)
IAS 26 – Accounting and Reporting by Retirement Benefit Plans
IAS 30 – Disclosures in the Financial Statements of Banks and Similar Financial Institutions
IAS 41 - Agriculture

Furthermore, of the remaining thirty standards SKF already fulfils the requirements in thirteen standards, which are listed in Table 2.

Table 2: Fulfilled standards

IAS 8 – Net Profit or Loss for the Period, Fundamental Errors & Changes in Accounting Principals
IAS 10 – Events After Balance Sheet Day
IAS 17 – Leases
IAS 20 – Accounting for Government Grants & Disclosure of Government Assistance
IAS 23 – Borrowing Costs
IAS 27 – Consolidated Financial Statements & Accounting for Investments in Subsidiaries
IAS 28 – Accounting for Investments in Associations
IAS 33 – Earnings per Share
IAS 34 – Interim Financial Reporting
IAS 35 – Discontinuing Operations
IAS 36 – Impairment of Assets
IAS 37 – Provisions, Contingent Liabilities and Contingent Assets
IAS 38 – Intangible Assets

Thus, there are seventeen standards in which there are differences between IAS and SKF GAAP. But, after studying the comments given by SKF's accountants, and the differences between IAS and SKF GAAP, there are four standards where SKF currently does not need to make any changes. These standards are listed in Table 3 as well as the reasons that the standards do not affect SKF. However, if the situation for SKF is changed the company has to follow these standards. Therefore, the requirements SKF has to fulfil are disclosed.

Table 3: Standards that do not affect SKF

IAS 7 – Cash Flow - Include bank overdrafts payable on demand in the line item 'cash and cash equivalents' - Disclose the amount of significant 'cash and cash equivalent' not available for group SKF: No material items
IAS 21 – The Effects of Changes in Foreign Exchange Rates - This standard is only affected by changes in IAS 29
IAS 31 – Financial Reporting of Interest in Joint Ventures - Distinguish between a venturer and an investor - The venture shall account for its share of jointly controlled operations; controlled assets, incurred liabilities and expenses, and its share of the income. SKF: No material items
IAS 40 – Investment Property - Recognise an asset called investment property SKF: Does not hold any investment properties

We conclude that there are actually thirteen accounting areas where differences currently exist between IAS and SKF GAAP. SKF must address these thirteen areas in order to be in compliance with IAS. We list the thirteen relevant IAS in Table 4, on next page, along with a brief explanation of the action required.

Table 4: IAS which SKF must fulfil

IAS 1 – Presentation of Financial Statements <i>- Disclose financial cost as a separate line in income statement</i>
IAS 2 – Inventories <i>- Disclose the carrying amount of inventories carried at net realisable value</i>
IAS 11 – Construction Contracts <i>- When the outcome of a construction contract cannot be estimated reliably, use the zero-profit method</i>
IAS 12 – Income Taxes <i>- Reclassification of all deferred tax liabilities and assets as noncurrent</i>
IAS 14 – Segment Reporting <i>- Update the structure of the segment reporting</i>
IAS 16 – Property, Plant and Equipment <i>- Change the principle for revaluation of assets and disclose commitment for acquired assets</i>
IAS 18 – Revenue <i>- Revenue should only be recognised to the extent of expenses recognised that are recoverable when the outcome of the transaction involving the rendering of service cannot be estimated reliably</i>
IAS 19 – Employee Benefits <i>- Define a multi-employer plan under the terms of the plans</i> <i>- Account for any constructive obligation that arises from the enterprise's informal practise</i> <i>- Use of the Projected Unit Credit Method for defined benefit obligation</i> <i>- Post-employment benefit obligation should include an estimation of future salary increases and changes in future costs of medical services etc</i> <i>- Disclose a general description of the type of plan</i>
IAS 22 – Business Combinations <i>- In-process research and development, included in a business purchase, should be capitalized</i>
IAS 24 – Related Party Disclosures <i>- Analyse the related parties</i>
IAS 29 – Financial Reporting in Hyperinflationary Economies <i>- Adjust financial statements for inflation and state in terms of the measuring unit current at the balance sheet date</i>
IAS 32 – Financial Instruments: Disclosure and Presentation <i>- Analyse the disclosure requirements of IAS 39</i>
IAS 39 – Financial Instruments: Recognition and Measurement <i>- Considerable uncertainty exists regarding this standard due to the recent exposure draft (Improvements to IAS 39, Financial Instruments: Recognition and Measurement and IAS 32 Financial Instruments: Disclosure and Presentation). Analyse the exposure draft and related comment letters in order to be better prepared for the implementation of IAS 39</i>

7.1.2 SKF GAAP's most affected areas

7.1.2.1 Type of changes

In the last section, it is revealed that there are differences between IAS and SKF GAAP that will require the 'Group Accounting and Reporting' department to change SKF's accounting principles. In order to determine whether or not the adoption of these thirteen IAS will result in significant changes in SKF's accounting principles, as well as to determine whether there will also be disclosure changes, we have studied the comments provided by SKF's accountants. The thirteen standards as previously listed in Table 4, are categorized in Table 5 according to the general type of change.

Table 5: Type of change

Type of change	Standards
Major Change in Accounting Principles	19, 29, 39
Minor Change in Accounting Principles	11, 16, 18, 22
Only Change in Disclosure	1, 2, 12, 14, 24, 32

For three standards major changes in the accounting principles are required in order to fulfil IAS, while minor changes are required for four standards. Finally, for six of the standards, the 'Group Accounting and Reporting' department only has to change SKF's disclosure procedures.

The department states that when considering the standards from an effort perspective, IAS 19 is the standard that will demand the greatest effort. The required changes for implementation of this standard imply a new way of making calculations for post employment benefits. The standard has a very complex set of rules, which makes it very difficult to analyse. Therefore, one accountant has been working fulltime for several months with this standard, which is a very rare situation for the implementation of a single accounting standard. On the other hand, according to the 'Group Accounting and Reporting' department, IAS 19 is similar to FAS 87. This similarity should simplify SKF's implementation of IAS 19 since SKF's larger subsidiaries have previously implemented FAS 87 for purposes of reconciliation with US GAAP.

Regarding IAS 29 the 'Group Accounting and Reporting' department claims the standard could be a problem, although the department has not evaluated the standard yet. However, in our comparison between IAS and SKF GAAP, we explained that the IAS accounting for reporting by enterprises in

hyperinflationary economies is significant different from the accounting currently used by SKF.

The ‘Group Accounting and Reporting’ department states that IAS 39 might be a very difficult standard to analyse since the standard has a very complex set of rules. SKF has started a project group in order to evaluate IAS 39. Another problem with IAS 39 is that the IASB has an exposure draft that will change the standard. Due to this exposure draft the department believes it is very difficult to analyse IAS 39 since the content in this standard probably will change.

According to Rippe (2001) a potential problem area with the implementation of IAS could be the updating of instructions to subsidiaries. Since IAS 19, IAS 29 and IAS 39 are all very complex standards, and compliance with them will require major changes in SKF’s accounting principles, updating the instructions to the subsidiaries may be a problem area.

7.1.2.2 Materiality

According to Wilson (2001) and Hofste (2002) it is of interest to assess the materiality of the changes in accounting principles when analysing the effect of implementation of new standards. When determining whether changes in accounting principles are material, the ‘Group Accounting and Reporting’ department states that SKF has no general rule. Rather, the department study each change individually and make a determination as to its materiality level. Based on this determination, and the effect on the result, disclosure in the financial statements may be required. The ‘Group Accounting and Reporting’ department only considers the changes that have to be made due to the implementation of IAS 19 to be material. The accounting theorists Hendriksen and van Breda (1992) state that the information may be material if the knowledge of this information may be significant to the users of accounting reports. Although, as stated above, SKF does not explicitly define materiality according to formal, theoretical accounting theory, it is reasonable to conclude SKF’s interpretation of materiality is similar to that expressed by Hendriksen and van Breda (1992) since SKF considers effects on the company’s results. The consideration of such effects, in making a materiality judgment, implies a financial statement user perspective.

7.1.2.3 Information available to comply with IAS

As noted previously for various IAS (see Table 5), SKF will have to change certain accounting principles. A concern is whether the necessary information to comply with those standards is available. We have studied if and where in SKF the information is available, or whether it is uncertain if the information is available. This was done by studying the comment on the differences between IAS and SKF GAAP provided by SKF's accountants. Table 6 presents the result.

Table 6: Information available to fulfil IAS

Information available to fulfil IAS	Standards
'Group Accounting and Reporting' department	1, 12
Subsidiaries	2, 16
No information is available	11, 18, 19, 22, 24, 29
Availability of information is uncertain	14, 32, 39

Table 5 shows that SKF needs to make major adjustments in IAS 19, IAS 29, and IAS 39 in order to fulfil IAS. Table 6 shows that for IAS 19 and IAS 29 neither the 'Group Accounting and Reporting' department nor the subsidiaries have the information required by these standards. Due to the uncertainties about IAS 39, owing to the current exposure draft, which may change the accounting for financial instruments, it is difficult to determine whether SKF has the information required in order to fulfil IAS 39.

7.2 Implementation of IAS

In this section we relate the theoretical research discussed in chapter 4 with SKF's implementation process, implementation difficulties and harmonization.

7.2.1 SKF's implementation process

Besecker (2001) argues that one individual should not carry out the whole planning process and in more complex undertakings; several individuals should be involved, when conducting an organisational change process. At SKF all accountants in the 'Group Accounting and Reporting' department are involved in the implementation process of IAS, even though the level of involvement differs from person to person. At the department, one of the accountants leads the work, but the head of the department has the main responsibility for the implementation. The allocation of IAS among the accountants depends on their previous knowledge and special knowledge of relevant issues.

For several years SKF has reconciled its Swedish GAAP financial statements to US GAAP, as this is required for its listing on the NASDAQ. Thus, the company is accustomed to understanding and making changes in its accounting principles. Therefore, it is not unexpected that SKF does not believe the implementation of IAS will be especially difficult. However, when studying the requirements for SKF to fulfil, listed in Table 4, IAS 19, IAS 29 and IAS 39 require significant change to SKF GAAP. For IAS 19 and IAS 29 the information is currently not available, and for IAS 39 it is uncertain whether SKF has the required information. Thus, due to major changes in SKF GAAP and the lack of available information at SKF for the requirements by these three standards, it is reasonable to conclude that the implementation of IAS 19, IAS 29, and IAS 39 will be complicated and time consuming. However, the 'Group Accounting and Reporting' department is aware of the possible difficulties with IAS 19 and IAS 39 since one accountant is working fulltime with IAS 19 and there is a project group for IAS 39. According to the 'Group Accounting and Reporting' department, there is enough time for the implementation. But one wonders, if there is enough time for the implementation, why go to the trouble to set aside one full time accountant, and why set up a project team. The department may have realised that the implementation of IAS might be more time-consuming than first expected.

As have been discussed above, there are major changes that need to be made in order to fulfil IAS 39. The argument to wait for the exposure draft to be implemented is to save resources since the IAS 39 probably will look quite different after the exposure draft is implemented. But, since US GAAP requires two years of comparable figures, in the financial statements of 2005 SKF must present its figures from January 2003 in compliance with IAS. Therefore, it is reasonable to argue that SKF does not have time to wait for the exposure draft about IAS 39 to be implemented, but should carefully analyse the exposure draft and its related comment letters.

SKF's approach, regarding analysing the effects of implementation of new accounting standards, has many advantages. However, in one area there is room for improvements. Theoretically, by appointing project groups for each standard, or at least for each standard that may cause major changes or interpretation difficulties, more focus would be assessed and the quality of SKF GAAP should be improved. SKF has appointed a project group for IAS 39. SKF explicitly declares that for that standard there are many more resources

allocated than for the other standards. Also, one accountant is working fulltime with IAS 19. Therefore, of the three standards listed in Table 5 that require major changes in SKF GAAP, IAS 29 is left for improvements. The reason for not appointing a project group for IAS 29 could be increased cost.

According to Dennis (1999), once the information is gathered about effects in various areas, accountants should try to understand the standard's broader impact. This area could also be improved by SKF, since the 'Group Accounting and Reporting' department does not discuss the new standard with those employees in the organisation who are affected by the new accounting standard. By having a discussion in the organisation about the new standard, the standards' logic could be explained for the affected employees in the organisation, and the implementation process would therefore be smoothed.

Dennis (1999) and Smith (1982) believe that after analysing the effects the implementation will have, the company should get comments from the external auditors. The 'Group Accounting and Reporting' department at SKF has a close relationship with the external auditors. Also, SKF typically consults closely with its external auditors on various accounting matters, including interpretations of new accounting standards.

7.2.2 Implementation difficulties

As discussed in chapter 4 a change is often met with resistance. One important argument, that the process of changing or implementing accounting standards should not be resisted by SKF's accounting employees, is that it is easier for employees to accept external changes since these changes can be regarded as more necessary. Therefore the European Commissions' regulation that requires all companies within the EU listed on a regulated market to prepare consolidated accounts in accordance with IAS, should be easy to accept by SKF's subsidiaries, since the reason for the change is an amendment in legislation. Therefore, the implementation process of IAS should certainly be facilitated.

According to SKF's 'Group Accounting and Reporting' department, when the accountants in the subsidiaries have to conduct more tasks and when the information is harder to obtain, these accountants might see this as an extra burden. An unknown future might be difficult for the accountants to cope with, since many individuals seek safety in a job. This is one of the most important

factors for resistance according to Erikson (1992) and Granlund (1998). But since the reason for the change is due to amendment of the legislation as discussed above, and since the 'Group Accounting and Reporting' department explicitly states that the employees in the subsidiaries are used to changes in the accounting principles, the implementation of IAS should not be met with resistance.

In addition to workplace change, another source of anxiety for employees results when external consultants are introduced to the organization structure (Tullberg, 2000). Besides the external auditors, 'Group Accounting and Reporting' department relies on external actuaries for calculations of employee benefits. However, as the external auditors and actuaries are not, and will not be, involved in the actual implementation process of IAS, we suggest their involvement is unlikely to increase tension among the accounting personnel.

7.2.3 Harmonization

Since SKF has subsidiaries all over the world there are many different local GAAPs in use. Therefore world-wide adoption of IAS for all SKF's subsidiaries would save a huge amount of time and money for these subsidiaries, and therefore for SKF as a group. The accountants in the subsidiaries would not be forced to prepare two sets of accounts, one in accordance with local principles and one in accordance with SKF GAAP.

Although the implementation of IAS is a requirement for EU-companies listed on a stock exchange, there is no such requirement for SKF's subsidiaries located outside the EU to use IAS in the local accounts if not required by the local legislation. According to the 'Group Accounting and Reporting' department, if the local legislation permits the use of IAS, it is still a decision for the subsidiary to decide whether to use IAS in the local accounts or not. Given this situation, where the subsidiary has the choice of whether to use IAS or not in its local accounts, the possibility of total harmonization in the use of accounting standards is limited for SKF.

Even if the subsidiaries followed IAS there would still not be total harmonization of SKF's accounting principles. As Combarros (2000) and Gray et al (2001) argue, harmonization for a company listed on several stock exchanges will be complicated since the company still has to prepare multiple sets of accounts and reports. There will not be a total harmonization since SKF

has to disclose the differences between SKF GAAP and US GAAP, in the reconciliation note for US GAAP. Conversely, a step toward harmonization was reached in October 2002 when the FASB and the IASB presented an agreement to a commitment to adopt compatible, high-quality solutions to existing and future accounting issues. In the future there is a possibility that SKF will experience more harmonization than the company does in the present situation.

8 Conclusions

In terms of the research objectives of the study, there are some conclusions to be drawn about the implementation of IAS in SKF. This chapter concludes these findings, which finally will end up with suggestions for further research.

Due to major changes in SKF GAAP and the lack of available information at present that is required for IAS 19, IAS 29, and IAS 39, the implementation of these three standards can be difficult. SKF's 'Group Accounting and Reporting' department has suddenly started an internal work with IAS, set aside one full time accountant for IAS 19, and set up a project team for IAS 39. Therefore it is reasonable to conclude that SKF has realised that the implementation of IAS is more time consuming than first expected.

Some of the largest obstacles seem to be IAS 39 and the IASB's exposure draft 'Improvements to IAS 39, Financial Instruments: Recognition and Measurement and IAS 32 Financial Instruments: Disclosure and Presentation' that probably fundamentally will change IAS 39 and the disclosure requirements in IAS 32. One approach that seems to be acceptable for SKF is to wait for the final versions of IAS 32 and 39 to be implemented. The argument to use this approach is that in October 2002 the FASB and the IASB presented an agreement to a commitment to adopt compatible, high-quality solutions to existing and future accounting issues. Therefore, it is possible that IASB will change IAS 39 towards FAS 133, which SKF uses for the reconciliation to US GAAP. Since the agreement between the IASB and the FASB was published after the exposure draft of IAS 39, there is a possibility the final version of IAS 39 will be a larger step towards US GAAP than revealed in the exposure draft. The reason for SKF not to wait for the final version of and IAS 39 to be implemented is that US GAAP requires two years of comparable figures. Therefore, in the financial statements of 2005, SKF must present its figures from January 2003 in compliance with IAS. Hence, we believe SKF does not have time to wait for the final version of IAS 39 to be implemented, but should carefully analyse the exposure draft and its related comment letters.

Although SKF does not explicitly define materiality according to formal, theoretical accounting theory, it is reasonable to conclude that SKF's interpretation of materiality is similar to that expressed in the discussed theory

since SKF considers effects on the company's results. The consideration of such effects, in making a materiality judgment, implies a financial statement user perspective.

By appointing project groups for each standard, or at least for each standard that may cause major changes or interpretation difficulties, more focus would be assessed, and the quality of SKF GAAP should be improved. SKF has appointed a project group for IAS 39, and one accountant is working fulltime with IAS 19. Hence, IAS 29 is left for improvements of the three standards that will cause major adjustments in SKF GAAP. Another area of improvements in SKF's implementation process is to have a discussion in the organisation about the new accounting standards. Hence, the standards' logic could be explained for the affected employees in the organisation, and the implementation process would therefore be smoothed.

The implementation of IAS should not be difficult in terms of resistance within the organisation. One reason is that changes in legislations are easy for employees to accept since changes in legislations are regarded as necessary. Another reason that the implementation of IAS in SKF will not cause any resistance is that the accountants in the subsidiaries are used to changes in the accounting principles. Also, as the external auditors and actuaries are not involved in the actual IAS implementation process, we conclude that their involvement is unlikely to cause anxiety among the accounting personnel.

SKF has subsidiaries all over the world in which there are many different local GAAPs in use. SKF only requires the subsidiaries to use IAS for the consolidated financial statements, not for the subsidiaries' local financial statements. Hence, SKF as a group could save both time and money by demanding that the subsidiaries use IAS in the local accounts, given that this is allowed due to local legislation. However, as the situation is today, where the subsidiary has the choice of whether to use IAS or not in its local accounts, the possibility of total harmonization in the use of accounting standards is limited for SKF.

Further, total harmonization of accounting principles will not become a reality for SKF until reconciliation for US GAAP is not obliged any more. However, there is a possibility that SKF will experience more harmonization in the future due to the agreement between FASB and IASB.

To conclude, companies listed on stock exchanges in the EU should start with the implementation process of IAS as soon as possible, and especially beware of the difficulties in the implementation of IAS 19, IAS 29, and IAS 39. The companies should devote resources for these technically advanced standards. By using project groups and communicate with those employees in the organisation who are affected by the new accounting standard, the instructions and understanding within the subsidiaries would be improved. Finally, multinational companies could save both time and money by demanding that their subsidiaries use IAS in the subsidiaries' local accounts, given that use of IAS is allowed due to local legislation.

8.1 Suggestions for Further Research

This study has been conducted on SKF, which is listed on stock exchanges both in Sweden and in the US. Due to this, SKF's accounting principles are a mixture between Swedish GAAP and US GAAP. It would be of interest to see a similar study on another Swedish company that is only listed in Sweden and not listed in US.

Further, it could be of interest to perform similar studies on companies in other businesses. This is due to the fact that all the IASB's accounting standards presently do not affect SKF, for example IAS 31 – 'Financial Reporting of Interest in Joint Ventures'.

Another area that would be interesting to study is to conduct a similar study in SKF after IAS has been implemented and compare the results from this study.

Also, a similar study on a large amount of companies in one specific industry would be of interest since the researcher would then be able to draw general conclusions.

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